# TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935

No. 173

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

SAMUEL A. SALVAGE

No. 280

SAMUEL A. SALVAGE, PETITIONER

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

**PETITIONS FOR CERTIORARI FILED JUNE 25, 1935, AND JULY 25, 1935**

**CERTIORARI GRANTED OCTOBER 14, 1935**

# SUPREME COURT OF THE UNITED STATES

## OCTOBER TERM, 1935

---

## No. 173

## GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

## SAMUEL A. SALVAGE

---

## No. 280

## SAMUEL A. SALVAGE, PETITIONER

vs.

## GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

---

**ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT**

---

INDEX


| | Original | Print |
|---|---|---|
| Proceedings before United States Board of Tax Appeals | 1 | 1 |
| Docket entries | 1 | 1 |
| Petition | 3 | 2 |
| Exhibit A—Notice for deficiency | 11 | 6 |
| Exhibit B—Claim for refund | 17 | 9 |
| Exhibit C—Memorandum of agreement, December 30, 1922 | 19 | 10 |
| Answer | 22 | 11 |
| Stipulation of facts | 24 | 12 |
| Exhibit A—Memorandum of agreement, December 30, 1922 | 28 | 14 |
| Exhibit B—Statement of counsel for petitioner | 31 | 16 |
| Exhibit C—Letter, Chas. E. Hendrexson to S. A. Salvage, March 13, 1929 | 32 | 16 |
| Memorandum re basis for Federal income tax, etc | 35 | 18 |
| Exhibit D—Income tax return for calendar year 1929 | 43 | 23 |

| | Original | Print |
|---|---|---|
| Proceedings before the United States Board of Tax Appeals—Con. | | |
| Memorandum opinion, Smith, M | 49 | 28 |
| Decision | 57 | 32 |
| Petition for review | 58 | 32 |
| Notice of filing petition for review | 64 | 35 |
| Statement of the evidence | 65 | 36 |
| Caption | 65 | 36 |
| Testimony of Samuel A. Salvage | 65 | 36 |
| Stipulation re transcripts of stockholders' meeting of December 15, 1922, and of directors' meeting of same date | 83 | 46 |
| Stipulation and order settling statement of evidence | 93 | 51 |
| Petitioner's exhibits: | | |
| 1—Power of attorney and contract, July 2, 1914 | 94 | 51 |
| 2—Agreement of December 30, 1922 | 101 | 54 |
| 3—Letter of December 30, 1922 | 103 | 56 |
| 4—Letter of December 30, 1922 | 104 | 56 |
| 5—Agreement of January 2, 1922 | 105 | 57 |
| 6 (Iden.)—Agreement of January 2, 1922 | 110 | 59 |
| 7—Agreement of December 23, 1913 | 117 | 63 |
| 8—Agreement of May 20, 1915 | 121 | 65 |
| 1—Claim for refund | 128 | 69 |
| Praecipe for record | 131 | 72 |
| Clerk's certificate [omitted in printing] | 133 | 72 |
| Proceedings in U. S. C. C. A., Second Circuit | 134 | 73 |
| Memorandum opinion, per curiam, setting case for reargument | 134 | 73 |
| Opinion, Swan, J | 136 | 74 |
| Decree | 140 | 78 |
| Clerk's certificate [omitted in printing] | 142 | 79 |
| Order extending time within which to apply for writ of certiorari, Case No. 280 | 143 | 79 |
| Orders allowing certiorari | 144 | 79 |

1 Before United States Board of Tax Appeals

Docket No. 67653

SAMUEL A. SALVAGE, PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

*Docket entries*

Appearances:
For Petitioner: John G. Jackson, Esq., George B. Brooks, Esq.
For Respondent: M. B. Leming, Esq.

1932

Sept. 10—Petition received and filed. Taxpayer notified. (Fee paid.)
Sept. 10—Copy of petition served on General Counsel.
Nov. 8—Answer filed by General Counsel.
Nov. 19—Copy of answer served on taxpayer. General Calendar.

1933

Oct. 17—Hearing set December 7, 1933.
Nov. 4—Application for Order to take depositions filed by taxpayer.
Nov. 8—Order to take depositions of S. A. Salvage entered.
Nov. 27—Deposition of Samuel A. Salvage filed (1). Copies served by Notary.
Dec. 7—Hearing had before Mr. Smith—Division 5, on the merits submitted. Stipulation of facts filed at hearing—Petitioner's Brief due 30 days. Respondent's brief 15 days thereafter—Petitioner's Reply 10 days thereafter.
Dec. 19—Transcript of hearing of December 7, 1933, filed.

2 1934

Jan. 4—Brief filed by taxpayer. Copy served January 8, 1934.
Jan. 16—Brief filed by General Counsel.
Jan. 22—Reply brief filed by taxpayer. January 22, 1934, copy served.
Jan. 31—Stipulation to correct transcript filed.
Mar. 6—Memorandum opinion rendered—Mr. Smith, Division 5. Judgment will be entered for Respondent.
Mar. 6—Decision entered—Mr. Smith, Division 5.
May 31—Petition for review by United States Circuit Court of Appeals, Second Circuit, with assignments of error filed by taxpayer.
June 2—Proof of service filed by taxpayer.
July 24—Motion for extension to September 1, 1934, to complete and transmit record filed by General Counsel.
July 24—Order enlarging time to September 1, 1934, to prepare and deliver record entered.
Aug. 22—Agreed statement of evidence lodged.
Aug. 22—Praecipe with proof of service thereon filed.

1934
Aug. 22—Agreed statement of evidence approved and ordered filed.
Sept. 1—Order enlarging time for transmission and delivery of record to September 22, 1934, entered.

3 Before United States Board of Tax Appeals

[Title omitted.]

*Petition*

Filed Sept. 10, 1932

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency dated July 12, 1932 (Bureau Symbols IT: AR: A-4 OSC-60D), and as a basis for this proceeding alleges as follows:

I. The petitioner is an individual whose address is 200 Madison Avenue, New York, N. Y.

II. That notice of deficiency, a copy of which is attached hereto, was mailed to the petitioner on July 12, 1932, as the petitioner believes. Said copy is marked "Exhibit A."

III. The taxes in question are income taxes for the year 1920. The deficiency is asserted as $12,005.38. The amount in controversy is the entire amount of the deficiency as asserted, and in addition thereto petitioner has filed a claim for refund in the amount of $63,750, being the amount of tax paid by petitioner by reason
4 of the redemption of certain stock of American Viscose Corporation held by him. Copy of said refund claim is hereto annexed and marked "Exhibit B."

IV. The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) The Commissioner erred in holding that on December 30, 1922, the date of the conversion of the stock of The Viscose Company into the stock of American Viscose Corporation, it was practicable to allocate a portion of the cost or value on the date of acquisition to the preferred and to the common stock, respectively, of the latter corporation, and in holding that any taxable gain was realized by the taxpayer before he had received back the base cost of The Viscose Company stock.

(b) The Commissioner erred in holding that the taxpayer was taxable upon the entire difference between the cost of the preferred stock of American Viscose Corporation as adjusted as of December 30, 1922, and the amount received by him upon the redemption thereof in 1929.

(c) The Commissioner erred in holding that the base cost of one share of The Viscose Company stock, or of its equivalent, in the stock of American Viscose Corporation, was $100.

(d) The Commissioner erred in holding that the taxpayer did not receive as additional compensation to him pursuant to contract the difference between $100 for each share of Viscose Company stock, or the equivalent in stock of American Viscose Corporation, and the actual value of such stock in the years when it was received.

(e) The Commissioner erred in failing to allow the taxpayer's claim for refund of $63,750.

V. The facts upon which taxpayer relies as the basis of this proceeding are as follows:

(a) On May 4, 1916, the taxpayer purchased 2,000 shares of the stock of The Viscose Company at a cost of $166.66⅔ per share. In 1919 he gave away 1,975 shares of this stock, leaving a balance of 25 shares on hand. On December 30, 1932, American Viscose Corporation was organized to acquire the Viscose Company with an authorized capital of 480,000 shares of 7% cumulative preferred stock, callable at $110 per share, and 520,000 shares of common stock of $100 par value. Pursuant to the plan of reorganization, each holder of stock of The Viscose Company became entitled to 4 shares of the preferred stock and 5 shares of the common stock of the new corporation in exchange for each share of the old stock held by him. This exchange resulted in the issuance of 415,820 shares of the new preferred stock and 519,775 shares of the common stock. In connection with the reorganization, the taxpayer made an agreement with The Viscose Company, of which he was president, pursuant to which he was permitted to purchase 1,500 shares of the stock of that company at $100 per share, said stock, however, except two-sevenths thereof, to be retained by The Viscose Company and one-fifth thereof delivered to the taxpayer during each of the succeeding five years unless said corporation decided to repurchase the same at $100 per share. As a consideration of the right given to the taxpayer he agreed that he would not at any time during his life engage in any trade, business, or occupation for the manufacture or production of artificial silk or any material, goods, or articles from the same, nor enter into the service of any person, firm, or corporation engaged in such business, without the express written consent of said company. A copy of said contract is hereto annexed and marked "Exhibit C."

By letter of even date with said contract, to wit, December 30, 1922, The Viscose Company consented that the new stock of the American Viscose Corporation be substituted under said agreement for said 1,500 shares of its stock. The result of this transaction was that the taxpayer received as additional compensation for his services as president of the Viscose Company and of its successor corporation, American Viscose Corporation, and as a consideration for his entering into the agreement, Exhibit C, during the various years when the stock was delivered to him the difference between $100 per share of The Viscose Company stock (or its equivalent in American

Viscose Corporation stock) and the actual value of said stock upon the date the same was received by him.

(b) As to the 25 shares of stock of the Viscose Company held by the taxpayer in December 1922 in addition to the 1,500 shares above
7 referred to, 20 shares of the same were exchanged for the stock of the American Viscose Corporation in the agreed proportions on December 30, 1922, and the remaining 5 shares were so exchanged on June 30, 1925.

(c) In 1929 American Viscose Corporation redeemed all of its preferred stock at its call price of $110 per share and the taxpayer received $671,000 for the 6,100 shares held by him.

(d) In December 1922 when the American Viscose Corporation was formed and took over the business of the Viscose Company the nature of the assets was such that it was impracticable to apportion between the preferred and common stock of the new company the percentage of the cost or value to be attributed to each.

No fair idea of the value of the assets of the Company could be obtained from its books. The principal items of value consisted of plant and equipment, exclusive contracts with experts, patents, secret processes and refinements, rights to feature patents and processes belonging to Courtaulds, Ltd., and goodwill.

In connection with plant and equipment it was the policy of the Company to have separate parts of machinery manufactured in different places, finished at the factory and there assembled into complete machines. No charge was made on the books for overhead expenses, such as supervision and engineering costs and increased value of completed machines.

A contract with Dr. Charles A. Ernst gave the Company the exclusive right to his services and any discoveries and inventions that he might make. Dr. Ernest was Chief Chemist for the
8 Company and was instrumental in the development of the method of eliminating fuzz from the yarn which for the first time made it usable for knitgoods. A large part of the success of the Company was due to his activities. A contract with Herbert P. Slater, Chief Engineer of the Company, contained provisions similar to those of the contract with Dr. Ernst. Mr. Slater invented numerous valuable improvements in machinery of the Company, particularly in connection with the increase of its output by improvement of its spinning machine. The patents used by the Company were basic and were indispensable to its successful operation. The secret processes and refinements were also essential to its profitable operation, consisting of adjustment and concentration of chemicals and regulation of temperatures in different steps of the manufacturing process. The contract with Courtaulds provided that that Company would give to The Viscose Company the fullest information and disclosure of all machinery and processes, secret or otherwise. Any

exact or even approximately exact valuation of the intangible assets above mentioned was impossible.

(e) The earnings of the two companies from 1914 to 1929, after payment of taxes, were as follows:

| | |
|---|---|
| 1914 | $1,334,852.73 |
| 1915 | 2,146,938.00 |
| 1916 | 6,569,745.00 |
| 1917 | 6,239,881.00 |
| 1918 | 3,860,908.34 |
| 1919 | 17,183,175.11 |
| 1920 | 15,960,981.97 |
| 9 1921 | 14,126,076.35 |
| 1922 | 26,796,540.43 |
| 1923 | 31,984,610.42 |
| 1924 | 23,956,381.17 |
| 1925 | 33,724,210.00 |
| 1926 | 27,609,050.03 |
| 1927 | 29,051,180.20 |
| 1928 | 31,645,901.98 |
| 1929 | 25,856,927.57 |

Based upon said earnings there was no substantial change in the value of the stock of American Viscose Corporation from 1922 through 1929 when the preferred stock here involved was redeemed. The taxpayer, therefore, upon the redemption of said preferred stock received nothing in addition to what he had given by way of cash and services pursuant to contract when the stock was delivered to him. The value of the preferred stock in each of the years from 1922 to 1927 was not less than $110 per share.

Wherefore, petitioner prays that this Board may hear the proceeding and determine:

(1) That it was impracticable to apportion the value of the preferred and common stocks of American Viscose Corporation on December 30, 1922, and that no taxable gain could have been received by the taxpayer until the whole amount paid by him for the stock had been recovered by him.

(2) That the base cost of the preferred stock to the taxpayer was its actual value on the date when received by him and not a fraction of the sum of $100 per share.

10 (3) That no taxable gain was realized by the taxpayer upon the redemption of the preferred stock of American Viscose Corporation in 1929.

(4) That the taxpayer is entitled to a refund of $63,750 with interest.

JOHN G. JACKSON,
GEORGE B. BROOKS,
(Signed) JOHN G. JACKSON,
(Signed) GEORGE B. BROOKS,
*Counsel for Petitioner,*
*15 Broad Street, New York, N. Y.*

[*Duly sworn to by Samuel A. Salvage, jurat omitted in printing.*]

11 *Exhibit A to petition*

[Copy]

NP-2-28
JULY 12, 1932.

IT:AR:A-4
OSC-60D

Mr. SAMUEL A. SALVAGE,
*200 Madison Avenue, New York, New York.*

SIR: You are advised that the determination of your tax liability for the year(s) 1929 discloses a deficiency of $12,005.38, as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

However, if you do not desire to petition, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your return(s) by permitting an early assessment of any deficiency and preventing the accumulation of interest charges,
12 since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; whereas if no agreement is filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully,

DAVID BURNET,
*Commissioner.*
By (Signed) J. C. WILMER,
*Deputy Commissioner.*

Enclosures:
Statement
Form 882
Form 870
NMC-2
627M

STATEMENT

IT:AR:A-4
OSC-60D

In re: Mr. Samuel A. Salvage, 200 Madison Avenue, New York, New York

Tax Liability

| *Year* | *Tax Liability* | *Tax Assessed* | *Deficiency* |
|---|---|---|---|
| 1929 | $140,761.10 | $128,755.72 | $12,005.38 |

The deficiency shown herein is based upon the report dated
13 November 30, 1931, prepared by Revenue Agent W. J. Lambie

and transmitted to you under date of December 28, 1931, which report is made a part of this letter.

Careful consideration has been accorded your protest dated January 11, 1932, in connection with the findings of the examining officer, the information submitted at a conference held in the office of the internal-revenue agent in charge and the information furnished in the conference held with your representative in this office on May 19, 1932.

This office holds, however, that the evidence submitted to substantiate your contention that the value of the stock of the Viscose Company was in excess of $354.58, the amount allowed is not sufficient to warrant any change in the agent's adjustment in this item.

Relative to your contention that it was impracticable to determine the basic cost attributable to each class of stock of the American Viscose Company received by you in exchange for stock of the Viscose Company and that on this account no profit on sale or redemption of any of this stock was realized, until all the basic cost had been recovered, you are advised that this is not in accordance with the Federal income-tax laws. The recoverable cost must be determined upon the sale of the shares of stock and not be recovered out of the proceeds of the earlier sales of stock before reporting a profit on sales made at a later date.

Accordingly the adjustments made by the revenue agent are approved.

In the determination of the deficiency of $12,005.38 careful consideration has been given to the information and the statement set forth in your claim for refund of $63,750.00.

14 A consent which will expire December 31, 1932, except as extended by the provisions of section 277 of the Revenue Act of 1928 is on file for the year 1929.

A copy of this letter has been furnished your representative, George B. Brooks, 15 Broadway, New York, New York, under the authorization of the power of attorney on file in this office.

SCHEDULE No. 1

Year ended: 12/31/29

NET INCOME

| | | |
|---|---|---|
| Net income as disclosed by return: | | |
| Ordinary net income | $368,329.23 | |
| Capital net gain | 516,833.34 | |
| | | $885,162.57 |
| As revised | | 981,205.76 |
| Net adjustment | | 96,043.17 |

(a) Capital net gain, 96,043.19.

## SCHEDULE 1-A

### Year: 1929

EXPLANATIONS OF ITEMS CHANGED

| | |
|---|---|
| (a) Capital net gain: | |
| Reported | $516,833.34 |
| Revised | 612,876.53 |
| Addition to income | 96,043.19 |

15 The taxpayer reported the following sale of 6,100 shares of the preferred stock of the American Viscose Corporation and treated the profit as capital net gain.

| | |
|---|---|
| Sales Price 10-1-29 | 671,000.00 |
| Cost 1919-1922 | 154,166.66 |
| | 516,833.34 |

Reference is made to the request for appraisal of the value of the stock to the Commissioner of Internal Revenue dated Apr. 7, 1931, in which is incorporated all of the detailed particulars in connection with the above transaction. Included as a part of the above request letter is a calculation of the value of the stock prepared by Price Waterhouse & Company, auditors for the American Viscose Corp., and which calculation was furnished to the field examiner by the taxpayer. The value of the above 6,100 shares arrived at in the calculation is $58,123.47.

According to the Bureau letter dated December 1, 1931, this value has been verified and approved by the Commissioner. It is here accordingly used as the basis for the computation of profit from the sale.

## SCHEDULE No. 2

### Year ended: 12-31-29

Computation of Tax

| | | |
|---|---|---|
| Net income (from Schedule 1) | | $981,205.76 |
| Capital net gain | | 612,876.53 |
| Income subject to surtax | | 368,329.23 |
| 16 Less: | | |
| Dividends | $482,456.83 | |
| Personal exemption and credit for dependents | 4,700.00 | |
| | | 487,156.83 |
| Balance subject to normal tax | | None |
| Surtax on $368,329.23 | 65,325.85 | |
| Tax at 12½% on capital net gain of $612,876.53 | 76,609.65 | |
| Total Tax | | 141,935.40 |
| Less: | | |
| Credit for earned net income (from Return) | 220.00 | |
| Income tax paid at source | 954.30 | |
| | | 1,174.30 |
| Total tax assessable | | 140,761.10 |
| Tax previously assessed | | 128,755.72 |
| Additional tax to be assessed | | 12,005.38 |

STATEMENT OF TOTAL TAX LIABILITY

| Year | Tax previously assessed | Adjustments proposed in accompanying report | | Correct tax liability |
|---|---|---|---|---|
| | | Deficiency | Overassessment | |
| 1929 | $128,755.72 | $12,005.38 | ---------- | $140,761.10 |

17 *Exhibit B to petition*

CLAIM

Form 843.

TREASURY DEPARTMENT,
INTERNAL REVENUE SERVICE.

Revised June 1930. To be filed with the Collector where Assessment was made or Tax Paid.

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse side.

Collector's Stamp (Date received).

X Refund of Tax Illegally Collected.

Refund of amount paid for stamps unused or used in error or excess.

Abatement of tax assessed (not applicable to estate or income taxes).

STATE OF NEW YORK,
*County of New York*, ss.:

Name of taxpayer or purchaser of stamps, Samuel A. Salvage.
Business address, 200 Madison Avenue, New York City.
Residence, Glen Head, Long Island, New York.

The deponent, being duly sworn according to law, deposes
18 and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed. Brooklyn, N. Y.
2. Period (if for income tax, make separate form for each taxable year) from Jan. 1, 1929, to Dec. 31, 1929.
3. Character of assessment or tax. Income.
4. Amount of assessment, $128,755.72; dates of payment, quarterly during 1930.
5. Date stamps were purchased from the Government.
6. Amount to be refunded. $63,750.00.
7. Amount to be abated (not applicable to income or estate taxes).
8. The time within which this claim may be legally filed expires, under Section 322 (b) 1 of the Revenue Act of 1928, on March 15, 1932.

The deponent verily believes that this claim should be allowed for the following reasons:

1. The taxpayer claims that the tax assessed against him and paid by him upon an alleged gain derived from the redemption at $110, per share of 6,000 shares of the preferred stock of American Viscose Corporation should be refunded by reason of the fact that he received said 6,000 shares of preferred stock on or about December 30th, 1922, as the result of a consolidation of The Viscose Company and said American Viscose Corporation; that he had purchased 1,500 shares of the stock of The Viscose Company at $100 per share on that date and that said stock of The Viscose Company upon the date of the purchase had a value greatly in excess of the amount paid therefor, which value has been found by the Government to have been $1,164.70 per share; that taxpayer was an officer of The Viscose Company, and in effect, in purchasing the stock of said company, at $100 per share, was receiving as additional compensation the difference between said $100 per share and the real value of said stock; that such difference in value could not be taxed in the year 1929.

2. The taxpayer further claims that the preferred stock of the American Viscose Corporation received by him in 1922 upon the consolidation of the two companies was in fact a dividend upon the stock of The Viscose Company held by him and was not in any way taxable in 1929. He therefore claims that there should be refunded to him the entire amount of the tax paid by him upon the alleged gain derived from the redemption of said stock, and he further claims that the additional assessment levied against him by reason thereof should be abated.

*Exhibit C to petition*

Memorandum of agreement, made and concluded this 30th day of December 1922, by and between The Viscose Company, a corporation of the State of Pennsylvania, hereinafter called "The Company", of the one part, and Samuel Agar Salvage, of the City of New York, hereinafter called "Salvage", of the other part,

Whereas the Company has, in consideration of the agreement of Salvage hereinafter set forth, sold to him or his nominees 1,500 shares of its capital stock at par, and has issued certificates therefor as directed by Salvage,

Now This Agreement Witnesseth:

1. That Salvage does hereby agree to and with the Company that the said Company shall have the right to repurchase from him or his nominees, and he does hereby undertake, on behalf of himself, his heirs, executors, administrators, and assigns, to procure for and deliver to the said Company for repurchase at par the following proportions of the said 1,500 shares:

At any time during the year 1923, five-sevenths;
At any time during the year 1924, four-sevenths;
At any time during the year 1925, three-sevenths;
At any time during the year 1926, two-sevenths;

At any time during the year 1927, one-seventh of the said 1,500 shares.

2. Salvage does further hereby agree to and with the Company that he will not at any time during his life in any part of the United States of America, except the States of Utah, Nevada, and New Mexico, Canada, the United Kingdom of Great Britain, or the
21 Free State of Ireland, directly or indirectly, alone or in partnership, or as a Director or other Officer of a corporate body or as an Agent or otherwise howsoever, carry on or be engaged in any trade, business, or occupation for the manufacture or production of artificial silk, rayon, or Viscose, or of any material, goods, or articles from Viscose in any form, nor enter into the service of or, directly or indirectly, assist or act for any person, firm, or corporation in such trade or business or manufacturing, or contemplating the manufacture of, artificial silk or rayon, without the express written consent of the said Company.

In Witness Whereof, The Viscose Company has caused its corporate seal to be hereunto affixed and the said Samuel Agar Salvage has hereunto set his hand and seal the day and year first above written.

[CORPORATE SEAL]

THE VISCOSE COMPANY,
By NELSON S. SPENCER,
*Chairman of the Board of Directors.*

Attest:

CHAS. E. HENDRIKSON,
*Secretary.*

SAMUEL A. SALVAGE. [SEAL]

22 Before United States Board of Tax Appeals

[Title omitted.]

## Answer

Filed Nov. 8, 1932

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition filed in the above-entitled appeal, admits, denies, and avers as follows:

I. Admits the allegations contained in paragraph I of the petition.

II. Admits the allegations contained in paragraph II of the petition.

III. Admits that the taxes in controversy are income taxes for the year 1929. Admits that the deficiency asserted is $12,005.38. Denies all other allegations contained in paragraph III of the petition.

IV. Denies that the Commissioner erred as alleged in paragraph IV, subparagraphs (a) to (e), inclusive, of the petition.

V. (a) Admits that on May 4, 1916, the petitioner purchased 2,000 shares of stock of The Viscose Company at a cost of $166.66⅔ per share. Admits that in 1919 the petitioner gave away 1,975
23 shares of this stock, leaving a balance of 25 shares on hand. Admits that on or about December 30, 1922, the petitioner purchased 1,500 shares of the stock of The Viscose Company for $100.00 per share. Denies all other allegations contained in subparagraph (a) of paragraph V of the petition.

(b) Denies all the allegations contained in subparagraph (b) of paragraph V of the petition.

(c) Admits that in the year 1929 stock of the American Viscose Corporation which petitioner owned was redeemed at a price of $110.00 per share, or for a total of $671,000.

(d) & (e) Denies all the allegations contained in subparagraphs (d) and (e) of paragraph V of the petition.

Denies generally and specifically each and every allegation contained in the taxpayer's petition not hereinbefore admitted, qualified, or denied.

Avers that the allegations set out in the petition, even if true, are insufficient to show that the deficiency asserted is overstated in any manner.

Wherefore, it is prayed that the Board redetermine the deficiency for the calendar year 1929 to be equal to the amount determined by the Commissioner, viz, $12,005.38.

(Signed) C. M. CHAREST,
C. M. CHAREST,
*General Counsel,*
*Bureau of Internal Revenue.*

Of Counsel:
F. R. SHEARER,
*Special Attorney,*
*Bureau of Internal Revenue.*

24 Before United States Board of Tax Appeals

[Title omitted.]

*Stipulation of facts*

Filed Dec. 7, 1933

The following facts may for the purposes of this proceeding only be taken as true without further proof, subject to the right of either party to object to their relevancy, and without prejudice to the right of either party to adduce other evidence.

1. On December 30, 1922, Articles of Incorporation of American Viscose Corporation were filed with the Secretary of State of Delaware. The said Articles of Incorporation provided for an authorized capital of 480,000 shares of 7% accumulative preferred stock of the par value of $100 per share, callable at $110 per share, and 520,000 shares of common stock at a par value of $100 per share.

2. The American Viscose Corporation issued 4 shares of its preferred stock and 5 shares of its common stock in exchange for each share of stock of the Viscose Company. This exchange took place on December 30, 1922, and resulted in the issuance by American Viscose Corporation of 415,820 shares of preferred stock and 519,775 shares of common stock for 103,955 shares of the Viscose Company. At the time of the exchange the Viscose Company had outstanding 104,000 shares of capital stock. After the aforesaid exchange of the American Viscose Corporation owned all of the outstanding stock of the Viscose Company except 45 shares, which were later acquired by it upon the same basis.

3. It is further stipulated that the "Memorandum of Agreement" annexed to the taxpayer's petition herein is the contract under which petitioner acquired 1500 shares of the Viscose Company by purchase at $100 per share on December 30, 1922. The original of said "Memorandum of Agreement" is hereto annexed as Exhibit A and by reference made a part hereof. It is understood and agreed that the petitioner may withdraw said original "Memorandum of Agreement" and that there may be substituted in its stead with the Board a photostat copy of the same. It is further stipulated, understood, and agreed that the document annexed to the petitioner's deposition, taken in this proceeding before W. G. Briggs, a Notary Public, at New York, N. Y., on November 22, 1933, is not the contract under which the aforesaid 1500 shares of stock of the Viscose Company were purchased by the petitioner. In explanation of the petitioner's testimony as set forth in the aforesaid deposition there is attached hereto as Exhibit B a statement of petitioner's counsel in his behalf.

4. In the determination of the deficiency herein the respondent, for the purpose of determining gain or loss on the sale or redemption of securities received by the petitioner in exchange for shares of stock of the Viscose Company, apportioned the original cost of the stock of the Viscose Company owned by the taxpayer as follows, to wit: 37.778% to the preferred stock of the American Viscose Corporation and 62.222% to the common stock of said American Viscose Corporation so acquired in said exchange. These percentages were arrived at by the respondent by giving to the preferred stock of the American Viscose Corporation a value at date of said exchange of $110 per share and a value of $144.94 per share of common stock of said American Viscose Corporation so received in said exchange. This calculation resulted in apportioning to the 6100 shares of preferred stock of the American Viscose Corporation, which were redeemed by the corporation for $671,000 in the year 1929, a cost basis of $58,123.47. In determining the gain derived by the petitioner upon the redemption of the 6,100 shares of preferred stock of American Viscose Corporation the respondent deducted the said sum of $58,123.47 from the sum of $671,000 and arrived at the gain to the petitioner upon said redemption of $612,876.53.

5. There is hereto attached as Exhibit C copy of a memorandum prepared by Price, Waterhouse & Company, together with a copy of a

letter written by Charles E. Hendrixson, Treasurer of the American Viscose Corporation, to the petitioner under date of March 18, 1929, in respect of the basis for Federal income-tax purposes of stocks of the American Viscose Corporation held by the petitioner and also by his wife.

27 6. On December 30, 1922, the Viscose Company declared a dividend of 400% on its capital stock. The amount of this dividend received by the American Viscose Corporation on account of its holdings of stock in the Viscose Company was $41,582,000, and was paid as follows:

| | |
|---|---|
| Cash | $1,013,543.53 |
| United States Liberty Bonds and accrued interest thereon | 31,908,286.12 |
| Capital stock of Claymont Park and Improvement Co., 370 shares of $100 par value | 37,000.00 |
| Capital stock of Viscose Corporation of Virginia, 800 shares no par value | 8,628,170.35 |
| Total | 41,582,000.00 |

On the same date the Viscose Corporation of Virginia declared a dividend of $2,000 per share on the 800 shares of its stock outstanding payable in cash. As the American Viscose Corporation had received these shares in part payment of the dividend of the Viscose Company referred to above, payment of $1,600,000 was made to the American Viscose Corporation in cash.

7. The respondent determined, as set forth in paragraph 4 hereof, an amount of $1,164.70 as the aggregate value of four shares of preferred and five shares of common stock of the American Viscose Corporation as of December 30, 1922, for the purpose of allocating thereto petitioner's cost of shares of Viscose Company. If, in

28 the consideration of this appeal, the Board of Tax Appeals or the Courts of Appeals should decide that the value of the stock of the Viscose Company as of said date is material, then and in that event the fair market value of the same may be found in the same amount, namely, $1,164.70 per share, diminished, however, according to the affect, if any, of any contract or other fact in evidence which, in the opinion of the Board or of the Courts of Appeals, may bear upon the fair market value of said shares.

8. There is annexed as Exhibit D the original income-tax return of the petitioner for the calendar year 1929. It is agreed that the said original return may be withdrawn by the respondent and a photostat substituted therefor.

(S.) GEO. B. BROOKS,
*Attorney for Petitioner.*

(S.) E. BARRETT PRETTYMAN,
*General Counsel, Bureau of Internal Revenue,*
*Attorney for Respondent.*

*Exhibit A to stipulation*

Memorandum of Agreement, made and concluded this 30th day of December 1922, by and between The Viscose Company, a corporation

of the State of Pennsylvania, hereinafter called "The Company", of the one part, and Samuel Agar Salvage, of the City of New York, hereinafter called "Salvage", of the other part,

29 Whereas the Company has, in consideration of the agreement of Salvage hereinafter set forth, sold to him or his nominees, 1,500 shares of its capital stock at par, and has issued certificates therefor, as directed by Salvage.

Now this agreement witnesseth:

1. That Salvage does hereby agree to and with the Company that the said Company shall have the right to repurchase from him or his nominees, and he does hereby undertake, on behalf of himself, his heirs, executors, administrators and assigns, to procure for and deliver to the said Company for repurchase at par, the following proportions of the said 1,500 shares:

At any time during the year 1923, five-sevenths;
At any time during the year 1924, four-sevenths;
At any time during the year 1925, three-sevenths;
At any time during the year 1926, two-sevenths;
At any time during the year 1927, one-seventh of the said 1,500 shares.

2. Salvage does further hereby agree to and with the Company that he will not at any time during his life in any part of the United States of America, except the States of Utah, Nevada, and New Mexico, Canada, the United Kingdom of Great Britain, or the Free State of Ireland, directly or indirectly, alone or in partnership, or as a Director or other Officer of a corporate body or as an

30 Agent or otherwise howsoever, carry on or be engaged in any trade, business, or occupation for the manufacture or production of artificial silk, rayon, or viscose, or of any material goods, or articles from viscose in any form, nor enter into the service of or, directly or indirectly, assist or act for any person, firm, or corporation, in such trade or business or manufacturing or contemplating the manufacture of artificial silk or rayon, without the express written consent of the said Company.

In witness whereof, The Viscose Company has caused its corporate seal to be hereunto affixed and the said Samuel Agar Salvage has hereunto set his hand and seal the day and year first above written.

THE VISCOSE COMPANY,
By NELSON S. SPENCER,
*Chairman of the Board of Directors.*

Attest:

CHAS E. HENDRIXSON,
*Secretary.*
SAMUEL A. SALVAGE [SEAL].

Memorandum of agreement between The Viscose Company and Samuel Agar Salvage.

Dated: Dec. 30, 1922.

*Exhibit B to stipulation*

Statement of George B. Brooks, Esq., counsel for petitioner

I prepared the petition filed in this proceeding September 10, 1932, to which is annexed as Exhibit C a "Memorandum of Agreement" under which the petitioner purchased 1,500 shares of stock of the Viscose Company. At the taking of petitioner's deposition before a notary public, W. G. Briggs, at New York, November 22, 1933, the petitioner was represented by John G. Jackson, Esq., and myself. The examination of the petitioner was conducted by Mr. Jackson. On that occasion the petitioner produced a Memorandum of Agreement bearing date of December 30, 1922, which he identified as "my copy of the original" contract under which he acquired 1,500 shares of capital stock of the Viscose Company. The said document was marked as Petitioner's Exhibit #2 to his said deposition. At the time of the production and marking of the said document as Petitioner's Exhibit #2, counsel for the petitioner did not compare it with the Memorandum of Agreement annexed to the petition herein as Exhibit C as aforesaid. After the deposition had been taken I discovered the discrepancy in the document and brought it to the attention of Mr. Sherriff, respondent's representative at the taking of said deposition. The explanation I now make in respect of the discrepancy in the two documents is that I have been informed by the taxpayer that the Memorandum of Agreement, copy of which is attached to the petition as Exhibit C and the original of which is hereto annexed as Exhibit A, superseded the Memorandum of Agreement marked as Petitioner's Exhibit #2 and filed with his aforesaid deposition. I was also informed that both documents were executed on the same date, to wit, December 30, 1922.

32

(s) GEO. B. BROOKS,
*Counsel for Petitioner.*

*Exhibit C to stipulation*

THE VISCOSE COMPANY,
*Marcus Hook, Pa., March 13, 1929.*

Mr. S. A. SALVAGE,
*#171 Madison Avenue, New York City, N. Y.*

DEAR MR. SALVAGE: I mailed you yesterday, calculations as made up by Price, Waterhouse and Company, defining the values of yours and Mrs. Salvage's stock in the American Viscose Corporation. At the time of mailing you the above statement I had not been able to check it over, but since I have done some figuring. I can quite realize that you can lose a lot of time arriving at the final figures, and I do not understand why our Auditors did not give you this in a short analysis at the end of their statement. I am giving you such an analysis by which you can arrive at what you are after quickly. The other, however, will prove a good statement to keep in case there is any question raised by the Internal Revenue Collector.

33

You first purchased on May 4th, 1916, two thousand (2,000) shares of The Viscose Company stock. Under date of June 5th, 1919, you

transferred to Mrs. Salvage, 1,975 shares, retaining 25 for yourself. Of this latter 25 shares, you converted 20 into American Viscose Corporation stock under date of December 30, 1922, and the remaining 5 shares you converted under date of June 30th, 1925. You then purchased under date of December 29th, 1922, 1,500 shares of The Viscose Company stock, which you converted into American Viscose Corporation stock under date of December 30th, 1922.

Mrs. Salvage received from you under date of June 5th, 1919, 1,975 shares of The Viscose Company stock, which she converted into American Viscose Corporation stock under date of December 30th, 1922.

Your present holdings and the dates acquired are as follows:

Mr. Salvage:
12/30/22—7,600 Shares Common Stock
7/1/25— 25 Shares Common Stock } 7,625 Shares
12/30/22—6,080 Shares Preferred Stock
7/1/25— 20 Shares Preferred Stock } 6,100 Shares

Mrs. Salvage:
12/30/22—9,875 Shares Common Stock.
12/30/22—7,900 Shares Preferred Stock.

Mr. Salvage purchased the first 2,000 shares of The Viscose Company stock at $166.66⅔, and the 1,500 shares at par, or $100.00 per share.

34 In the table below, I give you the cost of the original Viscose Company shares, and I also show in another column the cost to you of the American Viscose Corporation shares.

| Date Acquired | Viscose shares | Cost per share | Total Cost | Date of Conversion into A. V. Corp. Sh. | Cost to you of A. V. Corp. Shares now held by you |
|---|---|---|---|---|---|
| 5/4/16 | 20 | $166.66⅔ | $3,333.33 | 12/30/22 { 80 Pref. / 100 Com. | *$1,259.26 / 2,074.07 |
| 12/29/22 | 1,500 | 100.00 | 150,000.00 | 12/30/22 { 6,000 Pref. / 7,500 Com. | *56,667.00 / 93,333.00 |
| 5/4/16 | 5 | 166.66⅔ | 833.33 | 6/30/25 { 20 Pref. / 25 Com. | *197.21 / 636.12 |
| | | | 154,166.66 | | 154,166.66 |

Mr. Salvage sells 6,100 shares at $110.00, or a total of $671,000.00
Cost of above to Mr. Salvage, see above statement *58,123.47

Profit on sale of Preferred stock to Mr. Salvage, which is taxable 612,876.53

With reference to Mrs. Salvage's stock:

| Date Acquired | Viscose shares | Cost per share | Total Cost | Date of Conversion into A. V. Corp. Sh. | Cost to you of A. V. Corp. Shares now held by you |
|---|---|---|---|---|---|
| 6/15/20 | 1,975 | $364.58 | $720,045.50 | 12/30/22 { 7,900 Pref. / 9,875 Com. | *$272,018.79 / 448,026.71 |
| | | | 720,045.50 | | 720,045.50 |

| | |
|---|---|
| Mrs. Salvage sells her Preferred shares at $110.00 per share, or | $869,000.00 |
| Value of the above to Mrs. Salvage at the time she acquired same, see statement above | *272,018.79 |
| Profit to Mrs. Salvage, which is taxable | 596,981.21 |

From the above, you can also check out the cost to you of
35 the Common stock, and I think that you will find this statement clear, but if there is any question that you care to raise I will endeavor to answer same.

I have not, so far, endeavored to work up the valuations of the shares through the intricacies involved at the time of the transfers, but this was done very carefully by our Auditors and I think you can rely on same being correct.

It means quite a lot of digging to arrive at the definite figures, but if you want me to work into that further I will also be glad to do it for you.

Yours very truly,

(Sgd.) CHAS. E. HENDRIXSON,
*Treasurer.*

CEH.FO'D.

*Exhibit "C" to stipulation*

S. A. Salvage

Memorandum re basis for Federal income tax purposes of Stocks of American Viscose Corporation held by Mr. and Mrs. Salvage, computed from information submitted by Mr. C. E. Hendrixson

On May 4, 1916, Mr. Salvage purchased 2,000 shares stock of The Viscose Company at a cost of $166.66⅔ per share.

On June 5, 1919, Mr. Salvage donated to Mrs. Salvage 1,975 of the shares purchased by him on May 4, 1916. Under Sec. 113 (a)
(4) of the Revenue Act of 1928, the basis of these shares
36 in the hands of Mrs. Salvage was their fair market value at the time of their acquisition by her. Since the shares of The Viscose Company have never been listed for trading, and since there were no sales at or about the date of the gift that would indicate their fair market value, such a value can only be arrived at on the basis of their value as shown by the company's books at or near the date of the gift or on the basis of the valuation placed thereon for purposes of Federal taxation. There is not available a balance sheet of the company at June 5, 1919. The balance sheet, per books, at December 31, 1918, showed capital and surplus applying to the 100,000 shares outstanding at $18,981,659.27, and the balance sheet at December 31, 1919, showed capital and surplus of $30,916,593.27, an increase of $11,934,934.00. Assuming that the increase in the valuation occurred evenly throughout the year, the capital and surplus on May 31, 1919, a date conveniently close to June 5, 1919, would

have been $23,954,548.44, or $239.55 per share on the 100,000 shares then outstanding. This, however, does not take into consideration the additional value of the stock by reason of sustained earnings over and above a fair return on its net balance sheet assets. In the computation of the value of the stock for purposes of Federal capital stock tax this factor was taken into consideration and on the basis of earnings up to and including those for the calendar years 1918 and 1919 resulted in valuations for Federal capital stock tax purposes of $35,000,000.00 and $38,500,000.00, respectively. On the basis of these valuations, and assuming a steady increase in the
37 value of the stock throughout the year 1919, the stock would have had a value at May 31, 1919, a date sufficiently close to June 5, 1919, for all practical purposes of $36,458,333.33, or $364.58 per share on the 100,000 shares then outstanding. This value of $364.58 per share is considered the value, at the time of receipt by her, of the 1,975 shares of stock of The Viscose Company received as a gift by Mr. Salvage.

On December 30, 1922, Mr. Savage exchanged 1,520 shares stock of The Viscose Company for 6,080 shares of the 7% preferred stock of American Viscose Corporation and 7,600 shares of the common stock of that company. Of the shares so exchanged 20 shares had been acquired by him in May 1916 at a cost of $166.66⅔ per share, and the remaining 1,500 shares had been purchased on December 29, 1922, at a cost of $100.00 per share. It is assumed that Mr. Salvage did not include in his Federal income the tax return for the year 1922 an amount representing the difference between the cost of the 1,500 shares acquired at par on December 29, 1922, and their value at that date.

On December 30, 1922, Mrs. Salvage exchanged her 1,975 shares stock of The Viscose Company for 7,900 shares 7% preferred stock and 9,875 shares common stock of American Viscose Corporation.

The 7% preferred and the common stocks of American Viscose Corporation each have a par value of $100.00 per share.

Under Art. 600 of Regulations 74 it is necessary to divide the cost or other basis of the shares given in exchange for the shares of American Viscose Corporation received by Mr. Salvage and
38 Mrs. Salvage, on the basis of the respective values of each class of stock received at the date received by them.

The capital of American Viscose Corporation immediately subsequent to the reorganization on December 30, 1922, was as follows:

| | |
|---|---|
| Capital stock: | |
| 519,775 shares of common stock | $51,977,500.00 |
| 415,820 shares 7% cumulative preferred stock | 41,582,000.00 |

The company had neither surplus nor deficit at that date.

There were no sales of stock of American Viscose Corporation at or near December 30, 1922, on the basis of which the fair market values of the stocks issued by the company could be computed. All the shares outstanding had been issued in exchange for stocks of

subsidiary companies. The book value of $93,559,500.00 was represented by:

| | |
|---|---|
| Stocks of subsidiaries at price of acquisition less dividends declared | $59,037,670.35 |
| U. S. Securities | 31,908,286.12 |
| Cash and other assets, net | 2,613,543.53 |
| | $93,559,500.00 |

The value of the stocks of the subsidiaries held, as determined for purposes of Federal capital stock tax for the taxable year ending June 30, 1924, based on the balance sheets of the subsidiaries at December 31, 1922, and the earnings for the five years ending on that date, were as follows:

| | |
|---|---|
| The Viscose Co. 103,955 of $77,930,000.00 | $77,896,280.00 |
| 104,000 | |
| Viscose Corporation of Virginia | 8,624,000.00 |
| Claymont Park and Improvement Co. (estimated) | 35,000.00 |
| | $86,555,280.00 |

39 or $27,517,609.65 in excess of the value at which they were carried in the accounts of American Viscose Corporation.

On this basis of valuation, the only one available which takes into account the earning power of the company's stock, the stocks of American Viscose Corporation had a fair value of $121,077,109.65 on December 30, 1922.

Since the preferred stock is nonparticipating as to dividends and as to assets in excess of $110.00 per share on dissolution, and is callable at $110.00 per share, it could not be reasonably held that that stock had a value in excess of $110.00 per share at December 30, 1922. Deducting from the total value of $121,077,109.65 an amount of $45,740,200.00, representing the value of the 415,820 shares of preferred stock at $110.00 per share, there remains an amount of $75,336,909.65 applicable to the 519,775 shares of common stock, or $144.94 per share.

For each share of common stock of The Viscose Company received there were acquired in exchange the following stocks of American Viscose Corporation.

| | | | | |
|---|---|---|---|---|
| 4 shares preferred stock, value as above | $110.00 each | or | $440.00 | or 37.778% |
| 5 shares common stock, value as above | 144.94 each | or | 724.70 | or 62.222% |
| | | | $1,164.70 | 100.00% |

The basis of the shares of American Viscose Corporation acquired at December 30, 1922, on the above basis, is, therefore, as follows:

Mr. Salvage:

In respect to the shares acquired in exchange for 20 shares purchased in May 1916, at a total cost of $3,333.33:

| | | | | |
|---|---|---|---|---|
| 40 Preferred, 80 shares | 37.778% | or | $1,259.26, | or $15.741 per share |
| Common, 100 shares | 62.222% | or | 2,074.07, | or 20.741 per share |
| | 100.000% | | $3,333.33 | |

In respect to the shares acquired for 1,500 shares purchased in December 1922, at a total cost of $150,000.00:

| | | | |
|---|---|---|---|
| Preferred, 6,000 shares | 37.778% | or $56,667.00, | or $9.4445 per share |
| Common, 7,500 shares | 62.222% | or 93,333.00, | or 12.4444 per share |
| | 100.000% | $150,000.00 | |

Mrs. Salvage:

In respect of the 1,975 shares received as a gift in June 1919, and having a value at the time of receipt of $364.58 per share, or a total value of $720,045.50:

| | | | |
|---|---|---|---|
| Preferred, 7,900 shares | 37.778% | or $272,018.79, | or $34.43 per share |
| Common, 9,875 shares | 62.222% | or 448,026.71, | or 45.27 per share |
| | 100.000% | $720,045.50 | |

On June 30, 1925, Mr. Salvage exchanged the remaining 5 shares of the Viscose Company stock held by him for 20 shares preferred and 25 shares common stock of American Viscose Corporation.

The capital and surplus of American Viscose Corporation at December 31, 1924, and December 31, 1925, amounted to $94,333,247.70 and $94,753,719.48, respectively, an increase of $240,471.78 during the year 1925. The securities of subsidiaries owned at December 31, 1924, were carried in the accounts at a valuation of $59,000,-
41 670.35, the same as the value at which they were set up in the accounts upon acquisition in December 1922. The valuation of the stocks of subsidiaries owned was, however, determined by the capital stock tax division of the Treasury Department, on the basis of balance sheets at December 31, 1924, and earnings to that date, to be $157,883,000.00, or $98,882,329.65 in excess of the value at which those held by American Viscose Corporation were carried in its accounts. Since the valuation of $157,883,000.00 refers to the whole of the stocks of subsidiaries there should be deducted from this difference the value at which the stocks of subsidiaries not owned by American Viscose Corporation at December 31, 1924, but acquired on June 30, 1925, were taken up in its accounts, viz: $40,500.00, leaving a net excess of $98,841,829.65.

The fair value of the stocks of American Viscose Corporation at June 30, 1925, may thus be arrived at as follows:

| | |
|---|---|
| Capital and surplus, per books, December 31, 1924 | $94,333,247.70 |
| Excess of value of stock of subsidiaries as determined by the Treasury Department over value at which carried in the account of December 31, 1924, or at which acquired | 98,841,829.65 |
| One-half of net increase in surplus during year 1925 | 189,985.89 |
| | $193,365,063.24 |

This valuation may be applied as follows:

To 416,000 shares of preferred stock at $110.00 per share, $45,760,000.00.

To 520,000 shares of common stock $147,605,063.24, $283,856 per share.

In exchange for the remaining 5 shares stock of The Viscose Company, purchased in May 1916, at a total cost of $833.33, there
42. were, therefore, received the following shares of stock of American Viscose Corporation:

| | | |
|---|---|---|
| 4 shares of preferred stock, value as above $110.00 each, or | $440.00 | or 23.665% |
| 5 shares of common stock, value $283,856 each, or | 1,419.28 | or 76.335% |
| | $1,859.28 | 100% |

On the above basis the shares of American Viscose Corporation so received would have a basis for tax purposes as follows:

| | | | | |
|---|---|---|---|---|
| Preferred, 20 shares | 23.665% | or $197.21, | or $9.86 | per share |
| Common, 25 shares | 76.335% | or 636.12, | or 25.445 | per share |
| | 100.000% | $833.33 | | |

43

# INDIVIDUAL INCOME TAX RETURN

FOR NET INCOMES FROM SALARIES OR WAGES OF MORE THAN $3,000
AND INCOMES FROM BUSINESS, PROFESSION, RENTS, OR SALE OF PROPERTY

## For Calendar Year 1929

File This Return With the Collector of Internal Revenue for Your District on or Before March 15, 1930

Do Not Write in These Spaces
No. 1258

PRINT NAME AND ADDRESS PLAINLY HERE

Samuel A. Salvage
171 Madison Avenue,
New York City, New York State

Occupation President American Viscose Co.

Fold, Check, N.D. Examined
$ 327589
Case 1-New York

1. Are you a citizen or resident of the United States? Yes
2. If you filed a return for 1928, to what Collector's office was it sent? 2nd Dist. Ny
3. Is this a joint return of husband and wife? No
4. Name and address of husband or wife if a joint return was made and the Collector's office where it was filed: Katharine A. Salvage
5. Were you married and living with husband or wife on the last day of your taxable year? Yes
6. If not, were you on the last day of your taxable year separated or in your household were or more persons closely related to you?
7. If your status in respect to questions 5 and 6 changed during the year, state date and nature of change.
8. How many dependent persons (other than husband or wife) under 18 years of age or incapable of self-support were receiving their principal support from you on the last day of your taxable year? Three

### INCOME

| | Amount received | Deduct cost or other basis as per Schedule IV | |
|---|---|---|---|
| 1. Salaries, Wages, Commissions, etc. (State name and address of employer) Lentz Price, Co., 171 Madison Av. Ny | $ 2,000 | $ | $ |
| The Viscose Co. Marc & Stock Co. | 10,000 | | 12,000 - |
| Compensation in 1929 | | | |
| 2. Income from Business or Profession. (Attach Schedule A) | | | |
| 3. Interest on Bank Deposits, Notes, Corporation Bonds, etc. (except interest on tax-free covenant bonds) | | | 3,208 41 |
| 4. Interest on Tax-free Covenant Bonds, Upon Which a Tax was Paid at Source | | | 47,715 00 |
| 5. Income from Annuities. (Attach Schedule B) (State name and address) 1929 | 3,000 - | | |
| 6. Income from Fiduciaries. (State name and address) | | | |
| 7. Rents and Royalties. (Attach Schedule C) | | | |
| Profit from Sale of Real Estate, Bonds, etc. (Attach Schedule D) Losses | | | 302,122 27 |
| 8. Dividends on Stock of Domestic Corporations | | | 492 456 89 |
| 9. Taxable Interest on Liberty Bonds, etc. (Attach Schedule E) | | | |
| 10. Other Income (including dividends on stock of foreign corporations). (State nature of income) | | | |
| (a) 1924 Sec Sch attached | | | 233 266 02 |
| (b) | | | |
| 11. Total Income as Items 1 to 11 | | | 436 324 09 |

### DEDUCTIONS

| | | | |
|---|---|---|---|
| 12. Interest Paid | | 18 219 20 | |
| 13. Taxes Paid. (Explain in Schedule F) See Schedule F | | 41 216 68 | |
| 14. Losses by Fire, Storm, etc. (Explain in Table at head of page 2) | | | |
| 15. Bad Debts. (Explain in Schedule F) | | | |
| 16. Contributions. (Explain in Schedule F) See Sch attached | | 48 759 18 | |
| 17. Other Deductions Authorized by Law. (Explain in Schedule F) | | | |
| 18. Total Deductions as Items 12 to 18 | | 107 334 86 | |
| 19. Net Income (Item 12 minus Item 19) | | 329 24 | |

### EARNED INCOME CREDIT

| | | |
|---|---|---|
| 20. Earned Income (not over $20,000) | 20000 | - |
| 21. Less: Personal Exemption and Credit for Dependents | 4200 | - |
| 22. Balance (Item 21 minus 22) | 15800 | - |
| 23. Amount taxable at 1½% (not over $4,000) | 2 4200 | - |
| 24. Amount taxable at 2% (not over $8,000) | 4000 | - |
| 25. Amount taxable at 4% (Balance over $8,000 of Item 23) | 17800 | - |
| 26. Normal Tax 1½% of Item 23 | 60 | - |
| 27. Normal Tax 2% of Item 24 | 80 | - |
| 28. Normal Tax 4% of Item 25 | 692 | - |
| 29. Surtax on Item 21 | 180 | - |
| 30. Tax on Earned Net Income (total of Items 27 to 29) | 1632 | - |
| 31. Credit of 25% of Tax (not over 25% of Item 23, or $400) | 400 | - |

### COMPUTATION OF TAX (See Instruction 22)

| | | |
|---|---|---|
| 32. Net Income (Item 20 above) | 329,24 | 24 |
| 33. Less: Dividends (Item 9) | 324,24 | 24 |
| Interest on Liberty Bonds, etc. (Item 10) | - | |
| 36. Credit for Dependents | 1200 | - |
| 37. Personal Exemption | 3500 | - |
| 38. Total of Items 34 to 37 | 4700 | - |
| 39. Balance (Item 33 minus 38) | - | |
| 40. Amount taxable at 1½% (not over $4,000) | - | |
| 41. Balance (Item 39 minus 40) | - | |
| 42. Amount taxable at 2% (not over $4,000) | - | |
| 43. Amount taxable at 4% (Item 41 minus Item 42) | - | |
| 44. Normal Tax (1½% of Item 40) | - | |
| 45. Normal Tax (2% of Item 42) | - | |
| 46. Normal Tax 4% of Item 43 | - | |
| 47. Surtax on Item 33 (see Instruction 23) | 65235 | 84 |
| 48. Tax on Net Income (total of Items 44 to 47) | 65235 | 84 |
| 49. Tax on Capital Gain or Loss (12½% of Col. E, Sched. D) | 6460 | 17 |
| 50. Total of all taxes between Items 48 and 49 | 71695 | 01 |
| 51. Less Credit of 25% of Tax on Earned Income (Item 31) | 400 | - |
| 52. Total Tax (Item 50 minus 51) | 71295 | 01 |
| 53. Less Income Tax Paid at Source | 470 | 30 |
| 54. Income Tax paid to a foreign country or U. S. possession | | |
| 55. Balance of Tax (Item 52 minus Items 53 and 54) | 70824 | 71 |

### AFFIDAVIT

I swear (or affirm) that this return, including the accompanying schedules and statements, has been examined by me, and to the best of my knowledge and belief is a true, correct, and complete return made in good faith for the taxable year stated, pursuant to the Revenue Act of 1928 and the Regulations issued thereunder.

Subscribed and sworn to before me this 14th day of March, 1930.

Gertrude Hammes Agent
171 Madison Ave N.Y. City
(Address of witness)

(Official character)

An amended return must be marked "Amended" at top of return. Certificate of Assessment will be prepared only if requested on your

44

SCHEDULE A—INCOME FROM BUSINESS OR PROFESSION (See Instructions 2)

1. Total receipts from business or profession (state kind of business)

Cost or Gross Sales

2. Labor
3. Materials and supplies
4. Merchandise bought for sale
5. Other costs (Itemize below or on separate sheet)
6. Plus inventory at beginning of year
7. Total (Lines 2 to 6)
8. Less inventory at end of year
9. Net Cost or Gross Sales (Line 7 minus Line 8)

Enter "C," or "C or M," on Lines 6 and 8 to indicate whether inventories are valued at cost, or cost or market, whichever is lower.

Gross Business Deductions

10. Salaries not included on "Labor," in Line 2. (Do not deduct compensation for your services)
11. Interest on business indebtedness to others
12. Taxes on business and business property
13. Losses (explain in table at foot of page)
14. Bad debts arising from sales or services
15. Depreciation, obsolescence, and depletion (explain in table provided at foot of page)
16. Rent, repairs, and other expenses (Itemize below or on separate sheet)
17. Total (Lines 10 to 16)
18. Total Deductions (Line 9 plus Line 17)

| No. Shares | Description | Date Acquired | Cost | Amount Received | Profit | Loss |
|---|---|---|---|---|---|---|
| 100 shrs. | N.Y.Central | 9/13/28 | $17587.50 | $20781.00 | $3,193.50 | |
| 50 " | Und.Ill.Fisher | 11/7/28 | 5860.00 | 4913.00 | 1,053.00 | |
| 50 " | " " " | 4/9/29 | 5525.00 | 4979.85 | 554.25 | |
| 50 " | " " " | 6/21/29 | 6762.50 | 7413.00 | 650.50 | |
| 50 " | Elec.B. & S. | 9/17/28 | 8931.25 | 6940.50 | 1,990.75 | |
| 50 " | " " " | 6/11/29 | 5137.50 | 5185.50 | 48.00 | |
| 50 " | " " " | 9/30/29 | 8712.50 | 4263.00 | | 4,449.50 |
| 50 " | Amer.Superpr. | 1/12/29 | 4810.00 | 5310.50 | 500.50 | |
| 100 " | " " | 6/12/29 | 3940.00 | 5956.50 | 2,016.50 | |
| 50 " | Lambert Co. | 1/23/29 | 6406.25 | 7060.50 | 654.25 | |
| 50 " | Gen-Cable A | 2/14/29 | 5500.00 | 5713.00 | 213.00 | |
| 50 " | United Corp. | 5/1/29 | 2823.75 | 3401.75 | | |
| 50 " | " " | 5/5/29 | 2465.00 | 2676.75 | | 2,670.00 |
| 50 " | " " | 5/6/29 | 3502.50 | 3685.00 | | |
| 100 " | " " | 9/27/29 | 7205.00 | (1740.50) | | |
| | | | | (1834.25) | | |
| 50 " | Louisville Gas & Elec. | 6/15/29 | 2051.25 | 2200.25 | 151.00 | |
| 100 " | Pub.Serv.N.J. | 6/19/29 | 10016.25 | 11392.00 | 1,375.75 | |
| 50 " | Glidden Co. | 8/5/29 | 2983.75 | 2939.25 | | 44.50 |
| 50 " | Mont.Ward | 8/5/29 | 5862.50 | 6435.50 | 573.00 | |
| 50 " | " " | 9/22/29 | 8462.50 | 5489.25 | | 2,973.25 |
| 10 " | Chase Nat'l | 8/6/29 | 2274.25 | 2388.52 | 114.27 | |
| 50 " | Amer.& For.Pr. | 8/20/29 | 7662.50 | 8179.25 | 516.75 | |
| 50 " | " " " " | 9/6/29 | 8112.50 | 9648.00 | 1,535.50 | |
| 50 " | Elec.Pwr.& Lt. | 9/19/29 | 4947.50 | 2165.50 | | 2,082.00 |
| 50 " | Pullman | 9/25/29 | 4447.50 | 4325.50 | | 122.00 |
| 50 " | U.S.Steel | 10/9/29 | 10890.00 | 9235.50 | | 1,654.50 |
| 480 " | Atlas Powder | 7/12/29 | 43100.00 | 46284.00 | 3,184.00 | |
| $49,400. | U.S.Treas.notes | 8/9/28 | 48720.75 | 48609.06 | | 111.69 |
| 500 shrs. | Howe Sound | 8/21/28 | 33537.50 | 35142.50 | 1,605.00 | |
| $100,000. | City of Newark | 2/28/28 | 105255.52 | 98784.03 | | 6,471.29 |
| 5000 shrs. | Tobacco Products(exchanged for 5000 shrs. United Stores A | 1928 | 288015.00 | 16700.00 | | 311,315.00 |
| 2000 " | Cont. Oil (exchanged for 1212 shrs. 1928 Cont.Oil of Del. | | 39,168.00 | 26917.02 | | 12,250.98 |
| 1000 " | Amer/& For.Pwr. | 2/12/29 | 106025.00 | 115710.00 | 9,685.00 | |
| 500 " | Old Colony Tr. Ctfs. | 5/23/28 | 26000.00 | 25980.00 | | 20.00 |
| | | | $888,610.52 | $872,838.13 | $32,173.02 | $44,164.71 |
| | | | | Less profits | | 32,173.02 |
| | | | | Total losses, | | $11,991.69 |

a 17

45

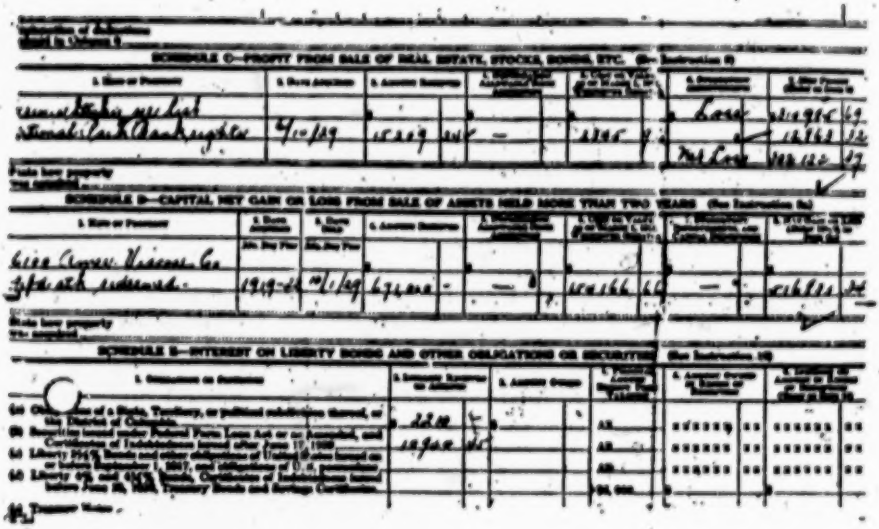
| | | | | |
|---|---|---|---|---|
| Item No. 11 | Commissions: | Viscose Corp. of Va. | | $21,740.51 |
| | | The Viscose Co., Pa., | | 200,998.95 |
| | | Lustre Fibres, Ltd., London, Eng. | | L 1,000.00 |
| | Directors' fees, Viscose Co., Pa. | | | L 1,000.00 ✓ |
| | Proceed: sale of rights: | | | |
| | Columbia Graph. | $733.74 | | |
| | Amer. Superpower | 79.05 | | |
| | Glidden, | 59.87 | | |
| | " | 46.92 | | |
| | Irving Tr. Co. | 18.98 | | 518.56 |
| | | Total | | $223,466.02 |

a18

| | | | |
|---|---|---|---|
| Item 14 | Taxes paid: | | |
| | N.Y. State Tax, | $18,535.37 | |
| | Real Estate | 22,141.14 | |
| | Club | 175.50 | |
| | Duty | 46.67 | |
| | Tax on stock, | 120.00 | |
| | Total, | $41,016.68 | |

a19

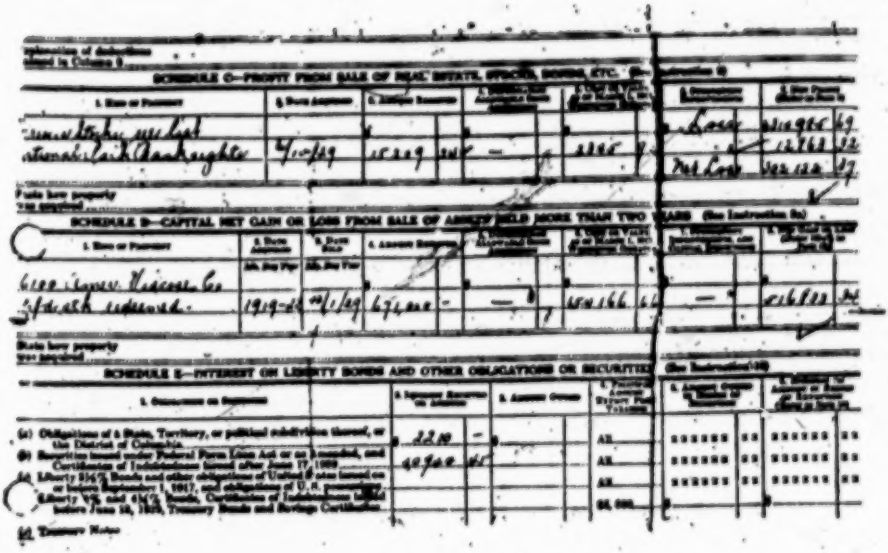
46



Item 17. Contributions:

| | |
|---|---|
| St. John's Hospital Building Fund, | $ 3,666.66 |
| Salvation Army, | 50.00 |
| Hope Farm, | 200.00 |
| Nassau Hospital, | 200.00 |
| American Red Cross | 50.00 |
| Fishers Island Health Nursing Assn., | 500.00 |
| Children's Shelter Fund, | 500.00 |
| Y. M. C. A., Nassau-Suffolk | 350.00 |
| St. George's Parish House Bldg. Fund, | 2,000.00 |
| St. George's Soc. of N.Y. | 417.50 |
| L.I. Biological Ass'n., | 100.00 |
| St. John's Church, Fishers Island, N.Y. | 500.00 |
| Oyster Bay Reformed Church, | 100.00 |
| Diocese of Long Island, | 100.00 |
| Police Relief Assn. of Nassau County, | 1,200.00 |
| Family Welfare Assn. Nassau County, | 25.00 |
| Foot Clinics of N.Y., | 25.00 |
| The Greenvale School, | 4,000.00 |
| Amer. Soc. Prevention Cruelty to Animals, | 100.00 |
| Amer. Foundation for the Blind, | 25.00 |
| Camp Fire Girls, | 25.00 |
| Church Mission of Help | 150.00 |
| Country Home for Convalescent Babies, | 250.00 |
| Nassau County Council Boy Scouts, | 500.00 |
| Lady Isabella Howard Fund, | 250.00 |
| Lattingtown Church, | 250.00 |
| Slater Mills Association, | 1,000.00 |
| Cathedral of St. John Divine Bldg. Fund, | 5,000.00 |
| Nassau County Soc. Prevention Cruelty to Children, | 25.00 |
| Fishers Island Union Chapel Society | 50.00 |
| Glen Cove Community Chest, | 200.00 |
| Welfare Federation of Chester & Vicinity, Chester, Pa., | 500.00 |
| North Country Community Assn., | 50.00 |
| Y. M. C. A. | 102.02 |
| Total, | $40,759.18 |

47



SCHEDULE C—PROFIT FROM SALE OF REAL ESTATE, STOCKS, BONDS, ETC.

| 1. Kind of Property | 2. Date Acquired | 3. Date Sold | 4. Selling Price | 5. Cost or Other Basis | 6. Net Profit | 7. Net Loss |
|---|---|---|---|---|---|---|
| [illegible] | | | | | | |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | | [illegible] |

SCHEDULE D—CAPITAL NET GAIN OR LOSS FROM SALE OF ASSETS HELD MORE THAN TWO YEARS (See Instruction 8a)

| 1. Kind of Property | 2. Date Acquired (Mo. Day Yr.) | 3. Date Sold (Mo. Day Yr.) | 4. Selling Price | 5. Cost or Other Basis | 6. Net Profit | 7. Net Loss | 8. Deduction for Depletion (Amount, Basis, Rate) | 9. Net Profit or Loss (Enter here and in Item 7a) |
|---|---|---|---|---|---|---|---|---|
| [illegible] | | | | | | | | |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | | | [illegible] |

SCHEDULE E—INTEREST ON LIBERTY BONDS AND OTHER OBLIGATIONS OR SECURITIES (See Instruction 10)

| 1. Description of Securities | 2. Interest Received or Accrued | 3. Amount Owned | 4. Interest Exempt from Normal Tax and Surtax | 5. Amount Owned at Beginning of Taxable Year | 6. Amount Owned at End of Taxable Year |
|---|---|---|---|---|---|
| (a) Obligations of a State, Territory, or political subdivision thereof, or the District of Columbia | 2210 — | | All | | |
| (b) Securities issued under Federal Farm Loan Act or as amended, and Certificates of Indebtedness issued after June 17, 1929 | 40[illegible] | | All | | |
| (c) Liberty 3½% Bonds and other obligations of United States issued on or before September 1, 1917, and obligations of U. S. issued under Liberty 3½% and 4½% Bonds, Certificates of Indebtedness dated before June 26, 1919, Treasury Bonds and Savings Certificates | | | All | | |
| (d) Treasury Notes | | | $5,000 | | |

EXPLANATION OF DEDUCTION FOR DEPRECIATION CLAIMED IN SCHEDULE A AND B

| 1. Kind of Property (If building, state material of which constructed) | 2. Date Acquired | 3. Cost When Acquired | 4. Prescribed Rate | 5. Amount Allowed or Allowable | Amount of Depreciation Claimed on 6. Previous years | Amount of Depreciation Claimed on 7. This year |
|---|---|---|---|---|---|---|
| | | | | | | |
| | | | | | | |
| | | | | | | |
| | | | | | | |

EXPLANATION OF DEDUCTION FOR LOSSES BY FIRE, STORM, ETC., CLAIMED IN SCHEDULE A, AND IN ITEM 10

| 1. Kind of Property | 2. Date Acquired | 3. Cost or Other Basis of Property Lost, Destroyed, or Damaged | 4. Depreciation Subsequent to Acquisition | 5. Amount Recovered through Insurance, etc. | 6. Deductible Loss |
|---|---|---|---|---|---|
| | | | | | |
| | | | | | |
| | | | | | |
| | | | | | |

49 Before United States Board of Tax Appeals

Docket No. 67653

SAMUEL A. SALVAGE, PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

John G. Jackson, Esq., and George B. Brooks, Esq., for the Petitioner.

Mason B. Leming, Esq., for the Respondent.

*Memorandum opinion*

SMITH. In this proceeding the petitioner contests the determination of a deficiency in income tax for 1929 of $12,005.38. The petitioner claims that not only is there no deficiency, but that he is entitled to a refund of $63,750.

The question in issue is the basis for the determination of profit derived by the petitioner in 1929 from the redemption by the American Viscose Corporation of 6,100 shares of 7 percent cumulative preferred stock owned by him.

In the early part of 1922 the petitioner was the owner of 25 shares of stock of The Viscose Co., which he had acquired on May 4, 1916, at $166.66⅔ per share. On December 15, 1922, The Viscose Co. increased its capital stock from 100,000 to 104,000 shares. The petitioner was permitted to acquire 1,500 shares of the new stock
50 at $100 per share, its par value, which was admittedly less than the real value. The acquisition was pursuant to a memorandum of agreement entered into between the petitioner and The Viscose Co. on December 30, 1922. Under the agreement The Viscose Co. retained the right to repurchase at par the following proportions of the said 1,500 shares:

At any time during the year 1923, five-sevenths;
At any time during the year 1924, four-sevenths;
At any time during the year 1925, three-sevenths;
At any time during the year 1926, two-sevenths;
At any time during the year 1927, one-seventh.

Under the same contract the petitioner agreed that he would—

"* * * not at any time during his life in any part of the United States of America, except the States of Utah, Nevada, and New Mexico, Canada, the United Kingdom of Great Britain, or the Free State of Ireland, directly or indirectly, alone or in partnership, or as a Director or other Officer of a corporate body or as an Agent or otherwise howsoever, carry on or be engaged in any trade, business, or occupation for the manufacture or production of artificial silk, rayon, or Viscose, or of any material, goods, or articles from Viscose in any form, not enter into the service of or,

51 directly or indirectly, assist or act for any person, firm, or corporation in such trade or business or manufacturing or contemplating the manufacture of artificial silk or rayon without the express written consent of the said Company."

The option above referred to was never exercised.

On the same date, December 30, 1922, the petitioner entered into another contract with The Viscose Co., whereby he obtained the right to exchange each share of stock so acquired by him "for shares of American Viscose Corporation of Delaware, at the rate of one share of your stock for four shares of the preferred and five shares of the common stock of said Delaware company."

On December 30, 1922, petitioner exchanged his 1,525 shares of The Viscose Co. stock, which had cost him $154,166.66, for 6,100 shares of the preferred stock of the American Viscose Corporation and 7,625 shares of common stock of that corporation. The preferred shares were callable at $110 per share and were redeemed at that figure in 1929, the petitioner receiving $671,000 upon such redemption.

In filing his income-tax return for 1929, the petitioner reported as capital net gain from the redemption of the shares of preferred stock in question, the difference between $671,000, the amount received, and $154,166.66, the entire cost of his 1,525 shares of The Viscose Co. common stock exchanged for the shares of preferred and common stock of American Viscose Corporation.

52 The respondent in determining the deficiency herein apportioned 37.778 percent of the petitioner's cost ($154,166.66) to the preferred and 62.222 percent to the common stock of the American Viscose Corporation to arrive at the true capital net gain. This apportionment was arrived at by giving to the preferred and common stock of the American Viscose Corporation values of $110 and $144.94 per share, respectively, as of the date of exchange. In this manner the respondent determined that the total cost to the petitioner of the 6,100 shares of preferred stock of the American Viscose Corporation was $58,123.47 and that the difference between that amount and $671,000, or $612,876.52, was the correct amount of the capital net gain.

In this proceeding the petitioner makes two contentions: (1) That he made a "bargain purchase" of the 1,500 shares of stock of the Viscose Co. on December 30, 1922; that the fair market value of such stock at that time was $1,164.70 a share; and that upon such calculation the petitioner was not taxable on any part of the proceeds of the preferred stock received by him in 1929; and (2) that it is impracticable to determine the market value of the shares of preferred stock and of the common stock of the American Viscose Corporation received by him in exchange for his shares of stock of The Viscose Co. on December 30, 1922, and that accordingly the only capital net gain is the amount returned by him, namely, the excess of $671,000 over his investment of $154,166.66 in the shares of stock of The Viscose Co.

At the hearing of this proceeding counsel for the petitioner stated that the petitioner had filed claim for the refund of $63,750 of the tax paid by him for 1929 upon the theory that the basis
53 for the determination of the gain realized from the redemption of the shares of preferred stock was the fair market value of the shares of stock of The Viscose Co. at the time he purchased 1,500 shares on December 30, 1922. Counsel for the petitioner stated:

"* * * In connection with the apportionment and, of course, for the purpose of apportionment, the Commissioner used the value for the old Viscose Company stock, of $1,164.70 a share, which value was accepted.

The petitioner contends that if a value could be arrived at, and if that value was $1,164.70 a share, it was very obvious that in buying that stock at $100 a share he bought it at a figure substantially less than its real value. He was an employee of the Company. The purchase was directly tied up with his employment. His testimony shows that he regarded it as remuneration for that purpose, and then he should not have paid any tax in 1929, and that is the basis of the claim for refund. I wish, of course, Your Honor, to make it clear that that point has only been presented by reason of the position taken by the Commissioner."

The testimony of the petitioner in this proceeding was taken by deposition. At page 41 of the deposition appears the following:

"Q. Do you now regard it as compensation for services rendered prior to 1922?

54 "A. I just feel that I made a bargain with the company in 1922, and that was closed, so far as I was concerned."

Again, at page 43:

"Q. Do you now regard that difference in value as compensation for services?

"A. I do not. I feel I made a deal with the company, and that ended it."

Again, at page 45:

"Q. You regarded the stock in part, anyway, as compensation, did you not?

"A. I regarded it as giving me an increased investment and interest in the business."

And, again, at page 51:

"Q. Did you attend all directors' meetings?

"A. Yes.

"Q. Can you state whether or not the directors in 1922 passed any minute authorizing this sale to you of the stock in consideration for your services?

"A. No.

"Q. They did not pass such a minute?

"A. No; there is nothing in connection with compensation for services. * * *"

And, again, at page 52:

"Q. Mr. Salvage, when did you first decide to treat this excess in value over $100 as compensation?

"A. I don't think I ever regarded it as compensation. I regarded it as a transaction whereby I bought something cheap."

The petitioner further deposed that neither for 1922 nor for any year subsequent thereto did he treat as compensation in his
55 income-tax returns any portion of the value of the shares of stock of The Viscose Co. which he received in that year; and that The Viscose Co. itself in its income-tax return never treated as compensation for services rendered any part of the claimed value of the shares of stock of The Viscose Co. sold to the petitioner. The petitioner, nevertheless, contends that under the Board's opinions in Albert Russel Erskine, 26 B. T. A. 147; William T. Bivin, 21 B. T. A. 105; G. Wildy Gibbs, 28 B. T. A. 18; and E. D. Knight, 28 B. T. A. 188; he is entitled to regard the fair market value of the shares of The Viscose Co. on December 30, 1922, as the basis for the computation of the cost to the petitioner of the shares of preferred and common stock of the Viscose Corpration received by him in exchange for his 1,525 shares of stock of The Viscose Co. We have carefully examined those opinions but do not consider them in point. The contentions of the petitioner upon this point are not sustained.

The point chiefly relied upon by the petitioner is that it was impracticable to allocate the cost of the petitioner's investment in the shares of stock of The Viscose Co. between the preferred and common shares of the Viscose Corporation received in exchange. The Commissioner has made the allocation in accordance with article 597 of Regulations 74. In making this allocation he has simply followed the allocation made by a firm of certified public accountants employed by the interested parties for the purpose of arriving at the taxable net gain under the respondent's regulations. Such computation was placed in evidence as a part of the stipulation of
56 facts by the parties. The petitioner contends there was no free market in the shares of the preferred and common stock of The Viscose Co. or of the Viscose Corporation either in 1922 or in any subsequent year; that the Board held in The Viscose Co., 3 B. T. A. 444, that the invested capital of The Viscose Co. could not be determined for invested capital purposes for the years 1917, 1918, and 1919; that in the course of its opinion the Board said, "It is impossible to determine the values of the mixed aggregate of tangible and intangible property"; hence, it is argued that a determination of the market values of the preferred and common shares based upon their book value is not accurate.

We are of the opinion that there is no merit in this contention of the petitioner. Possibly the fair market value of the common shares of the American Viscose Corporation at December 30, 1922, was in excess of $144.94 per share, the amount used by the above-referred

to firm of certified public accountants and adopted by the Commissioner. But if the fair market value was in excess of that amount it would only serve to reduce the cost allocable to the preferred stock and thereby increase the capital net gain realized by the petitioner from the redemption of his shares of preferred stock over the amount determined by the respondent. The finding of the respondent is approved upon the basis of Glenn H. Curtiss, et al., 21 B. T. A. 629; Philip D. C. Ball, 27 B. T. A. 388, 394; C. H. Mead Coal Co., 28 B. T. A. 599, 610; Tex-Penn Oil Co., 28 B. T. A. 917, 974.

Judgment will be entered for the respondent.

Enter:

Entered Mar. 6, 1934.

57 Before United States Board of Tax Appeals

Washington

Docket No. 67653

SAMUEL A. SALVAGE, PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

*Decision*

Pursuant to the determination of the Board, as set forth in its memorandum opinion, entered March 6, 1934, it is

Ordered and Decided: That there is a deficiency of $12,005.38 for the year 1929.

Enter:

Entered March 6, 1934.

[SEAL] (Signed) CHARLES P. SMITH,
*Member.*

58 Before United States Board of Tax Appeals

[Title omitted.]

*Petition for review*

Filed May 31, 1934

Taxpayer, petitioner in this cause, by John G. Jackson, counsel, hereby files his petition for a review by the United States Circuit Court of Appeals for the Second Circuit of the decision by the United States Board of Tax Appeals rendered on March 6, 1934, determining a deficiency in the petitioner's Federal Income Tax for the Calendar year 1929, and respectfully shows:

## I

The petitioner is an individual whose address is Glen Head, New York.

## II

### NATURE OF CONTROVERSY

The controversy involves the proper determination of the
59 petitioner's liability for Federal Income Tax for the Calendar Year 1929 and his right to obtain a refund of an amount paid as tax for said year.

On December 30, 1922, petitioner was the owner of twenty-five (25) shares of the Capital Stock of The Viscose Company, which he had acquired in 1916 at a cost of $166.66⅔ per share.

On December 30, 1922, the following events took place:

(a) A new corporation, American Viscose Corporation, was formed and offered to exchange for all of the stock of The Viscose Company its own stock, offering four shares of its $100 7% Cumulative Preferred Stock callable at $110 per share and five shares of its Common Stock of a par value of $100 per share for each share of said stock of The Viscose Company.

(b) Petitioner entered into a contract with The Viscose Company whereby he was permitted to acquire at $100 per share 1,500 shares of the stock of The Viscose Company, the issuance of which had been authorized by an increase of capitalization, and under which contract The Viscose Company retained the right to repurchase a portion of the stock at intervals in said contract set forth, and the petitioners agreed to certain restrictions upon his business activities.

(c) The Viscose Company consented that its repurchase contract be modified so as to permit the exchange of said 1,500 shares of stock for the stock of American Viscose Corporation in the ratio
60 above set forth, and accordingly the petitioner received for the 1,525 shares owned by him 6,100 shares of the Preferred Stock of said Company and 7,625 shares of the Common Stock.

In 1929 said Preferred Stock was redeemed at $110 per share and petitioner received $671,000 upon such redemption.

In filing his 1929 Return petitioner took the view that it was impracticable to allocate the original cost of The Viscose stock between the Common and Preferred Stock of the New Corporation and that he was therefore entitled to recover the full cost of said stock and was required to pay a tax only upon the excess received by him upon the redemption. The Commissioner, upon auditing said Return, took the position that said apportionment was practicable and by use of a formula arrived at an apportioned cost of said Preferred Stock of $58,123.47 and thus increased petitioner's tax in the amount of $12,005.38.

Petitioner urged before the Board of Tax Appeals that the theory of the Commissioner as to the practicability of such apportionment was incorrect and that the deficiency should not have been assessed, which contention, however, was overruled by the Board.

The second point involved in this controversy arises out of the fact that the Commissioner found in arriving at his apportionment figures that the market value of the stock of The Viscose Company on December 30, 1922, was $1,164.70 per share. This fact has been stipulated by both parties in the stipulation entered into upon the appeal to the Board. Petitioner contends that inasmuch as it is agreed that the above figure was the fair market value of the Viscose Com-
61 pany stock upon the date upon which he acquired it, and inasmuch as he was an employee of the Company and entered into an employment contract coincident with the purchase of said shares, that such purchase was in fact a so-called "bargain purchase" and that the difference between $1,164.70 per share and $100 per share in fact was additional compensation to him in 1922 and that he was not taxable upon any gain whatsoever by reason of the redemption in 1929, but on the other hand is entitled to a refund of $63,750.

Petitioner's counsel also entered objections to certain testimony taken upon the examination of petitioner by deposition, which objections are more fully set forth in the assignments of error herein contained.

III

The said petitioner being aggrieved by the Findings of Fact and Conclusions of Law contained in said Finding and Opinion of the Board, and by its decision entered pursuant thereto, desires to obtain a review thereof by the United States Circuit Court of Appeals for the Second Circuit.

IV

Assignments of Error

The petitioner assigns as error the following facts and omissions of the Board of Tax Appeals:

(1) The failure to find that it was impracticable to deter-
62 mine the market value of the shares of The Viscose Company stock on December 30, 1922, and to allocate a portion of such value between the Preferred and Common shares of American Viscose Corporation.

(2) The failure to find that the petitioner was entitled to deduct the entire cost of The Viscose Company stock from the amount received by him in 1929 from the redemption of the Preferred Stock of the American Viscose Corporation and to pay a tax only upon the excess.

(3) The holding that the petitioner is liable for a deficiency for the year 1929 of $12,005.38.

(4) The holding that the base cost of the stock of The Viscose Company to the petitioner was $100 per share.

(5) The failure to hold that the petitioner received as additional compensation under the contract of December 30, 1922, between petitioner and The Viscose Company, the difference between $100 per share and $1,164.70 per share upon the 1,500 shares of The Viscose Company stock covered by said contract.

(6) The failure to hold that the petitioner was entitled to a refund of $63,750.

(7) The reception in evidence and the consideration of the testimony of petitioner upon cross examination contained on pages 41, 45, 51, and 52 of the deposition, to all of which objection is taken.

JOHN G. JACKSON,
*Counsel for Petitioner.*

63 *Duly sworn to by John G. Jackson, jurat, omitted in printing.*

64 Before United States Board of Tax Appeals

[Title omitted.]

*Notice of Filing Petition for Review*

Filed June 2, 1934

Please Take Notice that the Petitioner on the 31st day of May, 1934, filed with the Clerk of the United States Board of Tax Appeals at Washington, D. C., a Petition for Review by the United States Circuit Court of Appeals for the Second Circuit of the decision of the Board heretofore entered in the above-entitled cause. A copy of the Petition for Review and the Assignments of Error, as filed, are hereto attached and served upon you.

Dated, New York City, this 31st day of May, 1934.

Respectfully,

(s) JOHN G. JACKSON,
*Counsel for Petitioner,*
*15 Broad Street,*
*New York City.*

Personal service of the foregoing Notice, together with a copy of the petition for review and assignments of error, mentioned therein, is hereby acknowledged this 1st day of June 1934.

(s) ROBERT H. JACKSON,
*General Counsel, Bureau of Internal Revenue,*
*Attorney for Respondent.*

65 In United States Circuit Court of Appeals for the Second Circuit

[Title omitted.]

*Statement of the evidence*

Filed Aug. 22, 1934

The above appeal was heard before Member Charles P. Smith, of the United States Board of Tax Appeals, on December 7, 1933. John G. Jackson and George B. Brooks appeared for the petitioner and Mason B. Leming for the respondent.

A stipulation of facts was entered into between the parties which stipulation has been made a part of the record. The only other evidence before the Board was the deposition of Samuel A. Salvage, the petitioner.

Samuel A. Salvage

Direct Examination:

Samuel A. Salvage testified that in 1908 he was engaged in the yarn business in his own name and that he represented mainly
66 English manufacturers. Salvage stated that he knew that in 1902 Courtaulds, Ltd., bought the Viscose patents for England from a firm called Gross & Bevan. Courtaulds would not export to the United States because someone in the United States owned the American rights to the Viscose patents. In 1906 Salvage was employed by Courtaulds, Ltd., as their agent in the United States. Later Salvage was asked by Courtaulds to develop their import business which turned out to be very successful. Courtaulds then organized a British corporation called Lustre Fibres, Ltd., licensed to do business in the United States. Salvage was made an agent for that corporation but since he had very little capital Courtaulds guaranteed all of his acts to all agencies that witness acquired, which were the French, Belgian, German, Austrian, Italian, Swiss, and English. Courtaulds also agreed to guarantee all credit risks and all of Salvage's acts. The contract between Lustre Fibres, Ltd., and petitioner was signed on July 2, 1914, and a copy was introduced as Petitioner's Exhibit No. 1.

The manufacture of artificial silk was begun in the United States in 1911. The business developed rapidly so Courtaulds, Ltd., purchased the Viscose patents for the United States and sent a director to this country with a view to building a plant here. This plant was built at Marcus Hook, Pennsylvania, in 1910, and began production in December of that year. This plant is still operating and is owned by Courtaulds and other shareholders. Courtaulds being the controlling stockholder. At the time the corporation at Marcus Hook was incorporated, Salvage had the agency for practi-

67 cally all foreign producers of rayon or artificial silk. In 1914 and after the sinking of the "Lusitania", business with Germany and Austria was discontinued but with other countries was increasing because Salvage developed the consumption of Rayon into hosiery. The United States became the largest consuming country in the world for rayon.

The Belgian agency was discontinued in 1921 and the Swiss agency in 1925. The basic patent that was purchased for the United States for viscose solution was terminated in 1920 and the Dupont Company went into competition with the Viscose Company. This company did not possess the technical ability to develop rayon so they went with the French and received all the technical assistance from the French, giving them a third of their stock for it in the new company they formed here. At that time Salvage was agent for the French companies. The French companies asked Salvage to resign, which he did. Dupont did not have the same quality of product that the Salvage agency had and, of course, could not force the French product on the consumers, and, therefore, Dupont was unsuccessful in selling the French product, so the French firm asked Salvage if he would renew the agency, which he refused to do. The Belgian firm requested Salvage to continue as their agent, but they were so lined up with the French interests that Salvage refused to go with them. This was in 1921. Other competitors came into existence at that time, such as Dupont Fibre Silk Company; Tubize Artificial Silk Corporation of America, Inc., which began business around 1920, and the American Borvisk Corporation of Cleveland was incorporated in 1917. The latter company is now owned by
68 the Industrial Fibre Corporation of America, which today is known as Industrial Rayon Corporation. They were all unsuccessful.

Salvage further testified that he started in business in his own name, S. A. Salvage, in 1907, and that his business grew as agent for British firms. Courtaulds requested witness to become their agent, and since their business grew so rapidly Courtaulds wanted Salvage to give up his business entirely and go with them. Salvage refused, but about two years later finally agreed on the terms Courtaulds gave him to give up his own business entirely. They stipulated that Salvage must not have a dollar invested in his own business and should come entirely with Courtaulds.

Salvage was paid any commissions he would have collected if he had remained in business. He was asked what he thought his business would bring five years hence, and he told them, so they started to pay him that then. Salvage's business was continued under the name of S. A. Salvage Company for a short time and then under another name, Salvage refusing to allow his name to be used further. When Salvage induced Courtaulds to buy the American patents, Courtaulds appointed Salvage agent for the American Viscose Company, which they formed here. Salvage was urged to give up his

business, and sold the same in 1912. Salvage from then on was agent for Lustre Fibres, Ltd., and the American Viscose Company (corporation), but was not an officer. Salvage's duties were administrative and selling. He managed the entire American business outside of production. When it came to tariff matters, he managed
69 them as he thought they should be managed, with no advice from the other side at all. Tariff protection for the rayon industry in the United States was given in 1914.

Salvage received a nominal salary from Lustre Fibres, Ltd., together with a minimum and maximum guarantee of commissions. The Viscose Company approved of Salvage being employed by Lustre Fibres, Ltd., in that way and they gave Salvage a salary plus an interest in the profits.

Prior to contract dated January 2, 1922, Salvage was working under a former agreement which gave him a salary and an interest in the profits and during the war period the profits were large, and when the war terminated the profits diminished considerable. The major shareholders felt that Salvage should receive some additional remuneration and in the latter part of 1919 they offered to double his interest in the profits of the business, which was not agreeable to Salvage. The shareholders felt that Salvage had put this offer into effect and had collected double profits in 1920 and 1921, which Salvage had not done. This resulted in bringing about the agreement of December 30, 1922, whereby the Viscose Company agreed to sell Salvage certain shares of stock. This agreement was offered in evidence as Petitioner's Exhibit No. 2.

Under this agreement the company had the right under Article 1 to repurchase the shares under certain conditions. This option was never exercised by the company. At the end of 1927 Salvage was in possession of 1,500 shares of stock. He lodged them with the company until he qualified. These shares were delivered to Salvage and issued in his name. These shares are still owned by Salvage or his wife.

70 The Viscose Company was reorganized into the American Viscose Corporation and Salvage exchanged one share of Viscose Company for four preferred shares of American Viscose Corporation and five shares common. Letters in regard to the 1,500 shares in question were introduced as Petitioner's Exhibits No. 3 and No. 4.

The Viscose Company reserved the repurchase right as stated in Paragraph 1, because it wished to assure itself of Salvage's continued services over this period of years. When Salvage started with the company for Courtaulds in 1911, it had a production of 320,000 pounds and today the production is over 75,000,000 pounds. It was through that constant growth that Courtaulds' confidence was maintained in the way Salvage was running the business. The growth was phenomenal. A new plant was built at Roanoke, Virginia, in 1917; another at Lewistown, Pennsylvania, in 1921; and another at Parkersburg, West Virginia, in 1927. The Company purchased a

plant at Nitro, West Virginia, and another plant at Meadville, Pennsylvania, in 1930. Production in 1911 was 320,000 pounds—in 1932, 70,000,000 pounds, and the capacity of the six plants today is over 75,000,000 pounds. These plants are running at full capacity. Over the period in question there has been a steady increase in production, as follows:

| *Year* | *Production* | *Imports* |
|---|---|---|
| 1918 | 7,386,000 lbs. | 290,000 lbs. |
| 1919 | 8,228,000 " | 1,150,000 " |
| 1920 | 10,180,000 " | 1,850,000 " |
| 1921 | 13,760,000 " | 3,670,000 " |
| 1922 | 19,670,000 " | 3,650,000 " |

71 In 1920, competitors in the United States produced 150,000 pounds; in 1921, 1,250,000; and in 1922, 4,830,000. Viscose production today is about 42% of the entire production of the United States.

The contract dated January 2, 1922, was offered in evidence as Petitioner's Exhibit No. 5.

The stock of the Viscose Company has never been listed on any exchange nor has there ever been any market in the stock over the counter or otherwise. Subsequent to December 1922, witness purchased 1,500 shares of stock of Viscose Corporation from Dr. Ernst for the company. Dr. Ernst was a chemist and when Courtaulds purchased the Viscose patents for this country together with a small firm called the Genasco Silk Company of Lansdowne, Pennsylvania, Salvage went to the plant and found Dr. Ernst and thought that Dr. Ernst knew more about the industry; the chemical end of it, than anyone else, and in buying the plant, negotiated his services and kept him in the company. Dr. Ernst remained with the company until 1925, when he was retired. During that period he was under a contract of employment. This contract of employment, dated January 2, 1922, was introduced in evidence as Petitioner's Exhibit No. 6.

When the industry was started in this country it was very secretive and Salvage felt it wise to keep it so, so in developing the business, purchases of machinery were made from two or three different sources, parts from each, which machines or parts were assembled by the Viscose engineering force in order to keep it secret. The expense of installation and assembling of different parts into an operating
72 unit was charged to current expense. The books did not reflect any capital value for the contract with Dr. Ernst nor did they reflect the capital value for any contracts with valuable employees. The Viscose Company had a contract with Courtaulds, Ltd., to acquire the patents for the Viscose solution which Courtaulds had for the United States. A copy of the contract, dated December 22, 1913, between Courtaulds, Ltd., and the American Viscose Corporation was introduced in evidence as Petitioner's Exhibit No. 7. Copy of the contract dated May 20, 1915, was introduced as Petitioner's Exhibit No. 8. These two contracts were never capitalized on the books of the company. A representative of Courtaulds came to the United States to assist in the operations of the Viscose Company in 1914, but not since that date up to the war. After the war a director of Courtaulds

came to the United States to look after the production end of the business. There was a constant exchange of ideas and development between Salvage and Courtaulds, Ltd., following this contract.

Dr. Ernst was responsible in a very large way for all chemical improvements in the industry. He improved the product until it had the highest quality in the world. Rayon yarn was not usable for knitting purposes at one time, but due to the refinements made by the company's chemists in the quality of the production it became usable. Dr. Ernst was concerned with this development.

Herbert P. Slater was Chief Engineer for the Viscose Company from 1910 to 1925, inclusive. His particular duties had to do with the mechanical operations such as spinning machines. He made
73 improvements under the directions of Dr. Ernst which were not capitalized on the books.

The patents acquired by Courtaulds and used by the Viscose Company were imperative in developing the business of the company. The secret processes were also of assistance. The plants were not open to the public and never have been. Salvage testified (Tr. 34) that it would not be possible to place a valuation on the intangible assets.

Cross-examination by Mr. SHERRIFF:

Salvage stated that from 1922 the production of the company had grown from 19,670,000 pounds to over 75,000,000 pounds in 1933. The production of the Viscose Company for the years 1923, 1924, and 1925 is as follows:

| | |
|---|---|
| 1923 | 26,856,000 pounds |
| 1924 | 27,040,000 " |
| 1925 | 34,635,000 " |

Since 1925 production has more than doubled.

Upon consolidation of the Viscose Company with the American Viscose Corporation in December 1922 Dr. Ernst, as well as Salvage, was given the rights to purchase the stock at $100.00 a share.

In December 1922 there were five other stockholders that Salvage knew of because Dr. Ernst had spread his shares around his family. The stockholders of the Viscose Company in 1922 were Dr. Charles A. Ernst, Samuel A. Salvage, Nelson S. Spencer, and A. G. Dickson of Philadelphia. Dr. Ernst owned 4½%; Salvage owned
74 2½%; Spencer, 1%; and Courtaulds, Ltd., owned the balance.

Salvage's compensation in 1922 was in the form of salary, commissions, and interest in profits, as covered by the contract (Exhibit 5), which contract fully covers Salvage's agreement of compensation with the Viscose Company.

On page 38 of the deposition the following appears:

"Q. In your 1922 income-tax return I presume you reported the entire compensation you received from the company?

"A. Yes.

"Q. Now, can you say whether that compensation includes any excess in the estimated value of this stock over $100?

"A. Yes; oh, you mean as worked out from that contract, do you?

"Q. I will frame the question in another way, if it will be helpful to you.

"Mr. JACKSON. I will concede the answer to that question, if you want.

"The WITNESS. Yes.

"Mr. JACKSON. That he did not include any difference between the hundred dollars a share, which Mr. Salvage paid, and the full value.

"The WITNESS. No; I did not.

"Q. Then, am I to understand that the salary as reported in 1922 in your personal income-tax return did not take into account this stock?

"A. No.

"Q. It only represented the money received from the Viscose Company?

"A. Actual cash received plus dividends.

"Q. Now, is the same true with respect to the years 1923, 1924, 1925, 1926, and 1927?

"A. Yes.

75 "Q. We are correct in assuming, then, that the income reported as compensation did not include any item of value of this stock above a figure of $100?

"A. Yes.

"Q. Can you give me any reason why you did not report that value or any portion of the value over $100 in your returns for any of those years?

"A. Yes. That was a bargain purchase I arranged with Courtaulds, Limited, for the Viscose Company stock.

"Mr. SHERIFF. I move that the answer be stricken out as not responsive and as being a conclusion and opinion of the witness. Now, read the question.

"(The question was read by the stenographer.)

"Q. Did you regard any portion of the value of that stock as salary to you or compensation for services?

"A. I regarded it as a bargain I made with the company.

"Q. Did you regard it as compensation for services?

"A. I felt they owed money to me.

"Q. Can you state, then, why you did not report any portion of that in your income tax return for 1922 or up to 1927?

"A. I do not see how I possibly could have arrived at any figure to do so, but I reported all the dividends from it.

"Q. Did you put anything in your return or make any statement to the effect that you had received compensation the amount of which could not be liquidated or estimated?

"A. No.

"Q. Mr. JACKSON. That is objected to, as the return speaks for itself.

76 "Q. Did I understand the answer was no?

"A. No.

"Q. You were president of the Viscose Company at that time, were you not?

"A. 1922?

"Q. 1922.

"A. No; I was vice president.

"Q. In that connection, did you have any knowledge concerning the preparation and filing of their income tax returns?

"A. The company's?

"Q. Yes.

"A. Yes; I was familiar with it.

"Q. Were you familiar in a general way with the expenses of the company?

"A. Yes.

"Q. Including the compensation of officers and employees?

"A. Yes.

"Q. Can you state whether the Viscose Company in 1922 made any deduction in its return for salary or compensation paid to you other than that which you reported in your return?

"A. No; it did not.

"Q. Are we to understand, then, that the Viscose Company made no deduction by reason of the value of this stock over and above $100?

"A. It did not. May I add, this was increased capital I purchased. You see, we increased our capital for these shares I purchased, you see.

"Mr. SHERIFF. I move that the last portion of the answer be stricken out as not responsive.

"Q. Do you now regard any excess in value of the stock above $100 in 1922 as having been compensation to you for services in that year?

"Mr. JACKSON. That is objected to on the ground that the terms of the purchase of shares of stock are evidenced by a con-

77 tract which has been put in evidence showing the consideration received by the company and the consideration which it exacted from Mr. Salvage.

"A. I regarded that I was entitled to it at the beginning of 1922.

"Q. And why do you say the beginning of 1922?

"A. Because that is when I acquired the stock.

"Q. Do you now regard it as compensation for services rendered prior to 1922?

"A. I just feel that I made a bargain with the company in 1922, and that was closed so far as I was concerned.

"Q. Well, now, going back to 1922, with respect to this so-called 'bargain', did you at that time regard this excess in value of stock over $100 as compensation to be paid by the company to you for services rendered to the company?

"Mr. JACKSON. I again object on the ground that the terms of purchase are expressed in the contract of December 30, 1922, which is in evidence as Exhibit 2, and which governs the transaction.

"A. My answer is I regarded my value to the company at the beginning of 1922 as sufficient worth to the company to sell me those shares at $100.

"Q. And did you regard this excess of value as compensation for services?

"A. Previous services.

"Q. And by that you mean what?

"A. 1920, 1921. May I explain to you this? In the beginning of 1920 the shareholders offered to double my interest in the profits and thought I had taken it. I never did. I never took any
78 increased compensation at all. And after it had gone on two or three years this was brought to their attention, and to reimburse me, or give back value for what I had given they sold me these shares at $100 each.

"Q. You considered, then, at that time that they were giving you this special price as compensation for your services?

"A. I felt they owed it to me.

"Q. Well, can you say now why you did not report or make any mention of that in your 1922 return?

A. I have always made my returns on the basis of cash received.

"Q. Then, if the company had given you any property instead of cash, you would not have reported the value of that as income or compensation for services?

"A. Well, what property?

"Mr. JACKSON. I object to that as an assumption as to what he would or would not have done, and it is entirely incompetent and irrelevant, not a transaction which occurred.

"A. Well, my answer is I don't know what property they could give me which would have been an asset.

"Q. Do you now regard that difference in value as compensation for services?

"A. I do not. I feel I made a deal with the company and that ended it.

"Q. Did you think the deal was made in view of services rendered to the company?

"A. I felt at the time of the consummation of the deal that I was worth more to the company.

* * * * * * *

79 "Q. When did you first determine to treat the difference in value of the stock above $100 as compensation for services rendered at any time to the company?

"A. I felt that if that stock should become worth much more it was entirely due to my own effort.

"Q. And when did that thought first occur?

"A. Probably about 1920.

"Q. And in 1922, did you in any way regard your so-called bargain or agreement to acquire this stock as compensation for services?

"A. No; I felt I was entitled to it.

"Q. For what reason?

"A. For the reason I would have—if I had not gotten it—I would have asked for an increased salary.

"Q. Then, you felt in 1922 that as long as you had gotten it that you had been given adequate compensation?

"A. You are asking me difficult questions because I will say I voluntarily reduced my salary from the company very materially about two or three years ago; not that I thought I was worth less but I did it in keeping with the times.

"Q. Why was there a provision in the contract, Exhibit 2, whereby the company might redeem certain portions of that stock from the years 1923 to 1927?

"A. Because the company felt that it would not wish to sell me that stock at $100 a share unless I remained in the employ of the company.

"Q. You mean, then, that was their way of assuring you employment until 1927?

"A. Yes.

"Q. And why were you willing to give that option or those options on that stock?

"A. Because I was so married to and interested in the company I wished to remain, and accepted these terms.

80 "Q. You regarded the stock in part anyway as compensation, did you not?

"A. I regarded it as giving me an increased investment and interest in the business.

"Q. If the options had been exercised by the company your investment would, of course, correspondingly have been decreased, would it not?

"A. Yes, but I would have had to have taken the initiative in the thing by getting out of the company.

"Q. Do I understand the company never exercised that option or any of those options to repurchase?

"A. No. The company could not."

Salvage stated that his salary in 1921 in addition to other compensation for services was $10,000 or $12,000 a year. He received other compensation besides salary. The compensation which Salvage received from the Viscose Company in 1921 was under contract introduced as Exhibit 5. This was the only compensation that Salvage received from the Viscose Company.

On page 47 of the deposition, the following appears:

"Q. So I am correct in understanding that the only compensation received by you, paid to you by the Viscose Company in 1922, was that covered by this contract, Exhibit 5?

"A. Yes.

"Q. Now, can you point out in this contract any reference to this sale of stock to you at a figure of $100?

"A. I think that was a separate contract, a separate agreement, wasn't it?

"Q. My question is whether there is anything in that contract of January 2, 1922, Exhibit 5, concerning the sale of stock to you?

"Mr. JACKSON. The sale wasn't made until nearly twelve months later.

81 "The WITNESS. No; there is nothing in this contract that I see. It permits me to be employed by another company at a salary and commission, and that is all; and, of course, the salary and commission from the other company was returned in my income-tax return. No; there is nothing in here relating to the share contract."

Salvage never filed any amended income-tax returns for the years 1922 to 1927, inclusive.

On page 49 of the deposition the following appears:

"Q. Can you tell us whether there is any minute authorizing the sale of this stock to you at $100 a share, in consideration for your services?

"A. No; I do not recall that. My recollection is that there is a minute (dated December 15, 1922) authorizing the increase of capital by $400,000 par value.

* * * * * * *

"The WITNESS. My answer would be that the Board of Directors of the Viscose Company were authorized to sell 4,000 shares of new stock, representing the proposed increase of capital stock of the company to the following-named persons: 2,500 shares to C. A. Ernst and 1,500 shares to S. A. Salvage."

Salvage was a director and attended stockholders' meetings. On page 51 of the deposition the following appears:

"Q. Can you state whether or not the directors in 1922
82 passed any minute authorizing this sale to you of the stock in consideration for your services?

"A. No.

"Q. They did not pass such a minute?

"A. No; there is nothing in connection with compensation for services. The directors of the Viscose Company held a meeting on the 15th of December and resolved that in the opinion of the board of directors of this company the four thousand shares of new stock, representing the proposed increase of the capital stock of this company, shall be sold at par to the following-named persons or their nominees: 2,500 shares to C. A. Ernst and 1,500 shares to S. A. Salvage.

"Q. This is taken from what?

"A. That is taken from a minute of the board of directors of the Viscose Company held on December 15, 1922.

"Q. Well, that is the same direction, then, as was contained in the minutes of the stockholders' meeting?

"A. Yes.

"Q. But no reference is made in there to compensation for services?
"A. None at all."

On page 52 of the deposition the following appears:

"Q. Was your compensation 1922, under your agreement of January 1922, in any way reduced by reason of the sale to you of the stock?
"A. No.
"Q. Mr. Salvage, when did you first decide to treat this excess in value over $100 as compensation?
"A. I don't think I ever regarded it as compensation. I regarded it as a transaction whereby I bought something cheap.

"Redirect examination by Mr. JACKSON:

"In 1922 each stockholder of the Viscose Company was
83 either connected with the company as an official or was a member of the family of one of the company's officials. Salvage was elected vice president in 1916 and president in 1925. Subsequent to Salvage's purchase in December 1922 of 1,500 shares of stock of the Viscose Company, Salvage purchased all of Dr. Ernst's common stock of the American Viscose Company for the company and paid $172.50 per share. This purchase was made in 1928, which was after Dr. Ernst left the company and after Salvage had been elected president."

On page 54 of the deposition, the following appears:

"Q. Mr. Salvage, when you filed your 1922 income-tax return, did you feel that in that year you had received any property of value or taxable income which was not included in your 1922 return?
"A. No."

On November 2, 1933, while the deposition of Samuel A. Salvage was being taken, the following stipulation was entered into between counsel for the petitioner and for the respondent:

*Stipulation*

"It is stipulated between counsel that the following are correct transcripts of the stockholders' meeting of the Viscose Company held December 15, 1922, and of the directors' meeting held the same date:

"'A Special Meeting of the stockholders of The Viscose Company was held at the general office of the Company, Marcus Hook, Pennsylvania, on the 15th day of December 1922, at 11:45 o'clock A. M.,
pursuant to the following resolutions adopted by the Board of
84 Directors of this Company at a meeting held at the general office of the Company on the 15th day of December 1922, at 11:30 o'clock A. M., the notice of this Meeting by publication required to be given by the Constitution and Laws of this Commonwealth, as well as the notice required by the By-Laws of this Company having been waived by the unanimous consent of the stockholders, in accordance with the waiver of notice hereafter set out.

"'Resolved, that the Capital Stock of this Company be increased from $10,000,000.00 to $10,400,000.00.

"'Resolved, that a Meeting of the Stockholders be called to convene at the general office of this Company on the 15th day of December, A. D. 1922, to take action on approval or disapproval of the proposed increase of the Capital Stock of this Company, the notice by publication required to be given by the Constitution and Laws of this Commonwealth having been waived by the unanimous consent of the Stockholders.

"'Resolved, that Messrs. Ernst, Salvage, and Dickson, Stockholders of this Company, be and they are hereby appointed Judges to conduct an election by the Stockholders thereof for or against an increase of the Capital Stock of this Company, to be held at the general office of this Company on the 15th day of December 1922, at 11:45 o'clock A. M.

85 "'Resolved, that the Secretary be and is hereby directed to furnish the Judges at said Meeting with a statement of the amount of the Capital Stock of this Company, the names of the persons or bodies corporate holding the same and the number of shares by each respectively held, which statement should be signed by him, with an affidavit thereto annexed that the same is true and correct to the best of his knowledge and belief.

"'Resolved, that in the opinion of the Board of Directors of this Company, the 4,000 shares of new stock representing the proposed increase of the Capital Stock of this Company shall be sold at par to the following-named persons or to their nominees:

"'2,500 shares to C. A. Ernst and 1,500 shares to S. A. Salvage.

* * * * * * * * *

"'(Waiver of notice incorporated in original minutes, but omitted here.)

"'Mr. Nelson S. Spencer was called to the chair and Mr. Hendrixson, Secretary of the Company, was appointed to act as Secretary of the Meeting.

"'The Secretary read the Minutes of the Directors' Meeting heretofore held on this date.

"'Waivers of notice of this Meeting signed by all of the Stockholders were read and ordered to be filed in the papers of the Meeting.

86 "'The Chairman stated that the Meeting was called for the purpose of taking action on the approval or disapproval of the proposed increase of the Capital Stock of the Company from $10,000,000.00 to $10,400,000.00.

"'The following resolution being offered, it was on motion resolved to proceed to a stock vote by ballot thereon.

"'Resolved, that the Board of Directors of this Company be, and they are hereby authorized to increase the Capital Stock of the Company from $10,000,000.00 to $10,400,000.00.

"'The judges appointed by the Board of Directors, namely, Messrs. Ernst, Salvage, and Dickson, respectively, took and subscribed the oath that they would well and truly conduct the election for or against the proposed increase of the Capital Stock of the Company.

"'The Secretary of the Company, in accordance with a resolution, furnished to the Judges of election a statement of the amount of the Capital Stock of the Company, with the names of the persons or bodies corporate holding the same and the number of shares by each respectively held, which statement was signed by the Secretary with his affidavit thereto attached that the same is true and correct to the best of his knowledge and belief.

"'A vote by ballot was then taken on said resolution, each ballot having endorsed thereon the number of shares thereby represented, and the Judges having counted the ballots, declared that the holders of 100,000 shares had voted in favor of said increase and that the holders of no shares had voted against said increase, and that, therefore, the persons or bodies corporate holding the larger amount in value of the Capital Stock of the Company had assented to such increase.

87

"'Duplicate returns of said election to increase the Capital Stock were made out by the Judges and subscribed and delivered to the Chairman.

"'The following resolution was thereupon offered and was unanimously adopted:

"'Resolved: That the Stockholders do hereby sanction the sale by the Board of Directors of the 4,000 shares, representing the new stock to be issued to the following-named persons or to their nominees:

"'2,500 shares thereof at par to Charles A. Ernst and 1,500 shares thereof at par to Samuel A. Salvage.

"'On motion adjourned.

"'(Blank) *Secretary.*'

"A Special Meeting of the Board of Directors of The Viscose Company was held at the principal office of the Company at Marcus Hook, Pennsylvania, on the 15th day of December 1922 at 11:30 o'clock A. M., pursuant to the following waiver of notice signed by all of the Directors:

88

"'WAIVER OF NOTICE

"'The undersigned, Directors of The Viscose Company, do hereby waive notice of a special meeting of the Directors of said Company to be held at the principal office of The Viscose Company, Marcus Hook, Penna., on December 15th, 1922, at 11:30 o'clock A. M., for the purpose of approving or disapproving an increase of the Capital Stock of the Company from $10,000,000.00 to $10,400,000.00, and of determining when and upon what terms such stock shall be issued.

"'There were present: Messrs. Nelson S. Spencer, Arthur G. Dickson, Samuel A. Salvage, Charles A. Ernst, being a majority and quorum of the Directors of the Company.

"'The Chairman of the Board, Mr. Nelson S. Spencer, occupied the chair.

"'The President stated the above waiver of notice set out the purpose for which this meeting has been called.

"'Whereupon, on motion, it was unanimously

"'Resolved: That the Capital Stock of this Company be increased from $10,000,000.00 to $10,400,000.00.

"'Resolved: That a meeting of the Stockholders be called
89 to convene at the general office of this Company on the 15th day of December, A. D. 1922, to take action on approval or disapproval of the proposed increase of the Capital Stock of this Company, the notice by publication required to be given by the Constitution and Laws of this Commonwealth having been waived by the unanimous consent of the Stockholders.

"'Resolved: That Messrs. Ernst, Salvage, and Dickson, Stockholders of this Company, be and they are hereby appointed Judges to conduct an election by the Stockholders thereof for or against an increase of the Capital Stock of this Company, to be held at the general Office of this Company on the 15th day of December 1922, at 11:45 o'clock A. M.

"'Resolved: That the Secretary be and is hereby directed to furnish the Judges at said Meeting with a statement of the amount of the capital stock of this Company, the names of the persons or bodies corporate holding the same and the number of shares by each respectively held, which statement should be signed by him, with an affidavit thereto annexed that the same is true and correct to the best of his knowledge and belief.

"'Resolved: That, in the opinion of the Board of Directors of this Company, the 4,000 shares of new stock, representing the proposed increase of the capital stock of this Company, shall be
90 sold at par to the following-named persons or to their nominees:

"'2,500 shares to C. A. Ernst and 1,500 shares to S. A. Salvage.

"'On motion, adjourned to 12 o'clock noon.

"'(Blank) *Secretary.*'

"'Adjourned Meeting of the Board of Directors of The Viscose Company held on the 15th day of December 1922, at 12 o'clock noon, at Marcus Hook, Pennsylvania.

"'Present: Nelson S. Spencer, Arthur G. Dickson, Samuel A. Salvage, Charles A. Ernst, being a majority and quorum of the Directors of the Company.

"'The President reported that the Stockholders at their special meeting held this date had unanimously voted in favor of a proposed increase of the Capital Stock from $10,000,000.00 to $10,400,000.00,

and had sanctioned the sale of the new shares at par to Messrs. Ernst and Salvage or to their nominees.

"'On motion duly made, seconded and carried, it was

"'Resolved, that the authorized Capital stock of this Company be increased from $10,000,000.00 to $10,400,000.00.

91 "'Resolved, that the 4,000 shares of new stock to be sold at par to the following-named persons or to their nominees:

"'2,500 shares thereof to Charles A. Ernst and 1,500 shares thereof to Samuel A. Salvage.

"'Resolved, that the Officers be, and they are hereby, authorized and directed in due course to make all proper returns in respect of such increase.

"'Resolved, that the Company enter into a new service agreement with Mr. C. A. Ernst and Mr. S. A. Salvage dating as from January 1st, 1922, for a period of six years, in the form presented to the Meeting by Mr. Dickson, the Company's Counsel.

"'On motion, adjourned.

(Blank) "'*Secretary.*'"'

At the hearing held before Hon. Charles P. Smith on December 7, 1933, counsel for petitioner stated that the petitioner had filed claim for the refund of $63,750 of the tax paid by him for 1929 upon the theory that the basis for the determination of the gain realized from the redemption of the shares of preferred stock was the fair market value of the shares of stock of The Viscose Company at the time he purchased 1,500 shares on December 30, 1922. Counsel for the petitioner stated:

"Now, as an alternative point, the petitioner presents this:

92 In connection with the apportionment and, of course, for the purpose of apportionment, the Commissioner used the value for the old Viscose Company stock, of $1,164.70 a share, which value was accepted.

"The petitioner contends that if a value could be arrived at, and if that value was $1,164.70 a share, it was very obvious that in buying that stock at $100 a share he bought it at a figure substantially less than its real value. He was an employee of the company. The purchase was directly tied up with the employment. His testimony shows that he regarded it as remuneration for that purpose, and then he should not have paid any tax in 1929, and that is the basis of the claim for refund. I wish, of course, your Honor, to make it clear that that point has only been presented by reason of the position taken by the Commissioner."

The claim for refund referred to, which was dated March 8, 1932, was received in evidence at the hearing on December 7, 1933, as Petitioner's Exhibit 1.

93 *Stipulation and order approving and settling statement of the evidence*

It is hereby agreed between the parties hereto through their respective attorneys of record that the foregoing is all of the material evidence adduced at the hearing before the Board of Tax Appeals and the same is hereby approved.

GEORGE B. BROOKS,
*Attorney for Petitioner on Review.*
ROBERT H. JACKSON,
*Assistant General Counsel for the Bureau of Internal Revenue.*

The foregoing is all of the material evidence adduced at the hearing and in order that the same may be preserved and made a part of the record, this statement of evidence is duly approved and settled this 22nd day of August, 1934.

CHARLES P. SMITH,
*Member, United States Board of Tax Appeals.*

JDH/nvc 8/17/34

94 PETITIONER'S EXHIBIT No. 1

Consulate-General of the United States of America for Great Britain & Ireland at London

I, Herbert D. Jameson, Deputy Consul-General of the United States of America at London, England, do hereby make known and certify to all whom it may concern that John Edward Newton, who hath signed the annexed Certificate, is a Notary Public, duly admitted and sworn, and practising in the city of London, aforesaid, and that to all acts by him so done full faith and credit are and ought to be given in Judicature and thereout.

In Testimony Whereof, I have hereunto set my hand and affixed my seal of Office at London aforesaid, this Second day of July, in the year of our Lord One Thousand Nine Hundred and Fourteen.

[SEAL] HERBERT D. JAMESON,
*Deputy Consul-General.*
DEC. 23, 1926.

UNITED KINGDOM OF GREAT BRITAIN AND IRELAND,
*England, City of London, ss:*

I, John Edward Newton, Notary Public of the City of London, by Royal Authority duly admitted, and sworn, and practising in said City, Do Hereby Certify unto all whom it shall or may concern
95 that on the day of the date hereof before me personally came and appeared Thomas Paul Latham, Henry George Rushbrook, and Ernest Kettle, to me personally known, who being by me each duly sworn did severally depose and say: That they resided in London, that they are respectively two of the Directors and the

Secretary of Lustre Fibres, Limited, the Corporation described in and which executed the annexed Instrument, that they knew the Seal of said Corporation, that the Seal affixed to said Instrument was such Corporate Seal, that it was so affixed by order of the Board of Directors of said Corporation and that they signed their names thereto by like order.

Whereof an Act being required I, the said Notary, have granted these Presents under my Notarial Firm and Seal of Office, to serve and avail as occasion shall or may require. Done and Passed in London this Second day of July, One thousand nine hundred and fourteen.

In testimonium—Veritatis.

[SEAL]

J. EDW. NEWTON,
*Notary Public, London.*

To Whom These Presents Shall Come Lustre Fibres Limited duly incorporated under the laws of the United Kingdom of Great Britain and Ireland, whose registered office is at No. 19, Aldermanbury in the City of London, England, send greeting

Whereas the said Lustre Fibres Limited (hereinafter called
96 "the Company") was formed for the purpose (inter alia) of carrying on business in the United States of America as importers and sellers of filaments, threads, or fibres usually known or referred to and hereinafter described as "Artificial Silk" and as Agents fo the sale of Artificial Silk

And Whereas it is intended that Samuel Agar Salvage, of No. 445 Broome Street, in the City of New York, State of New York, shall in the said United States have charge of such business and the Company are desirous of appointing him the Attorney of the Company for the purposes thereof as hereinafter appearing

Now These Presents Witness that the Company doth hereby appoint the said Samuel Agar Salvage (hereinafter called "the said Attorney") the Attorney of the Company in the name or on behalf of the Company in the said United States and not elsewhere to do or execute all or any of the acts and things hereinafter mentioned, that is to say

1. To direct, superintend, carry on, manage, and conduct the business assets and property of the Company in the said United States And for the purposes aforesaid

2. To use and dispose of all the stock, money, and effects of the Company in the said United States which now are or shall hereafter be employed in or be due or owing in respect of the said business.

3. To continue the employment of such clerks, agents, and other persons as are now employed in or about the said business
97 and from time to time to hire or employ such other persons and at such remuneration by way of salary as the said Attorney shall think proper, and subject to any existing agreements, to dismiss any clerks, agents, and other persons from time to time em-

ployed and appoint another or others and from time to time to increase or diminish the number of persons employed.

4. In the name and on behalf of the Company to draw, endorse, negotiate, or deliver any bills of exchange, promissory notes, cheques, drafts, orders for payment or delivery of money, securities, artificial silk and other goods or effects, bills of lading and other negotiable or mercantile instruments or securities deemed necessary or proper in relation to the business or affairs of the Company in respect of the business aforesaid.

5. To adjust and settle all accounts and transactions, and compromise or compound any debts or claims which may be or become owing by or to the Company in relation to the said business.

6. To demand, sue for, enforce payment of, and receive all monies, securities for money, debts, artificial silk and other goods, chattels and personal estate of or to which the Company is now or may hereafter become possessed or entitled or which are or may become due, owing, payable, or transferable to the Company in relation to the said business.

7. To receive and give effectual receipts and discharges for all monies, securities for money debts, artificial silk and other
98 goods, chattels, and personal estate which shall come to the hands of the said Attorney under or by virtue of the powers herein contained, which receipts shall exonerate the person or persons, corporation or corporations paying or delivering the same from seeing to the application thereof, or being responsible for the loss or misapplication thereof.

8. To open an account or accounts in the name of the Company with any Banker or Banking Corporation in the State of New York on such terms and conditions in all respects as the said Attorney shall think expedient and deposit any monies received for and on behalf of the Company and with such Banker or Banking Corporation to the credit of the said account or accounts, and from time to time as such Attorney personally or by some person duly authorised in writing by him to withdraw all or any of the monies standing to the credit of the same account or accounts, and to employ or apply all or any part of the monies so withdrawn for the purposes aforesaid as the said Attorney may think fit.

9. To commence, prosecute, enforce, defend, answer, or oppose all actions and other legal proceedings and demands attaching to any of the matters aforesaid in relation to the said business, and if thought fit, to compromise, refer to arbitration, abandon, submit to judgment, or become nonsuited in any such action or proceeding as aforesaid.

10. To adjust, settle, compromise, or submit to arbitration any accounts, debts, claims, demands, disputes, and matters touching any of the matters aforesaid in relation to the said business.

99 11. To compound and accept payment in lieu of and in satisfaction of the whole or to compromise any debt or sum of money now or hereafter owing or payable to the Company or any

other claim or demand which the Company has or may have or to grant any extension of time for the payment or satisfaction thereof on such terms as may be deemed proper either with or without taking security for the same or otherwise to act with respect thereto as the said Attorney may deem expedient.

12. To consent, enter into, acknowledge, perfect, sign, and do all such agreements, instruments, and acts and things as may be required by or for the Department of Customs or any other Government Department in the said United States or shall be deemed proper for or in relation to all or any of the purposes or matters aforesaid in relation to the said business.

13. And generally in the said United States to act as the Attorney or Agent of the Company in relation to any of the matters aforesaid and for or on behalf of the Company to do all acts and things hereinbefore mentioned as fully and effectually in all respects as the Company itself could do.

14. And the Company hereby ratifies and confirms and agrees to ratify and confirm whatsoever the said Attorney shall do or purport to do under or by virtue of these presents.

15. And the said Attorney is hereby authorized and empow-
100 ered to acknowledge in the name of the Company as the Company's act and deed this Power of Attorney and to register and record the same when and wherever required and to procure to be done any and every other act and deed whatsoever which may be in any wise requisite and proper for authenticating or giving full effect to this Power according to the laws and usages of the said United States.

In Witness Whereof Lustre Fibres, Limited, hereunto causes its Common Seal to be affixed this second day of July, One thousand nine hundred and fourteen.

The Common Seal of Lustre Fibres, Limited, was hereto affixed in the presence of—

T. P. LATHAM,
H. GEO. RUSHBROOK,
*Directors.*
E. KETTLE, *Secretary.*

Witness:
J. EDW. NEWTON,
*Notary Public, London.*

Dated the 2nd day of July 1914.

Power of attorneys from Lustres Fibres, Limited, to Mr. S. A. Salvage.

101 PETITIONER'S EXHIBIT No. 2

Memorandum of Agreement, made and concluded this 30th day of December 1922, by and between The Viscose Company, a corporation of the State of Pennsylvania, hereinafter called "The Com-

pany", of the one part, and Samuel Agar Salvage, of the City of New York, hereinafter called "Salvage", of the other part.

Whereas the Company has, in consideration of the agreement of Salvage, hereinafter set forth, sold to him or his nominees 1,500 shares of its capital stock at less than their real value, namely, at par, and has issued certificates therefor as directed by Salvage

Now This Agreement Witnesseth:

1. That Salvage does hereby agree to and with the Company that the said Company shall have the right to repurchase from him or his nominees, and he does hereby undertake, on behalf of himself, his heirs, executors, administrators, and assigns, to procure for and deliver to the said Company for repurchase at par, the following proportions of the said 1,500 shares:

At any time during the year 1923, five-sevenths;
At any time during the year 1924, four-sevenths;
At any time during the year 1925, three-sevenths;
At any time during the years 1926, two-sevenths;
At any time during the year 1927, one-seventh of the said 1,500 shares.

102 2. Salvage does further hereby agree to and with the Company that he will not at any time during his life, in any part of the United States of America, except the States of Utah, Nevada, and New Mexico, Canada, the United Kingdom of Great Britain, or the Free State of Ireland, directly or indirectly, alone or in partnership, or as a Director or other Officer of a corporate body, or as an Agent or otherwise howsoever, carry on or be engaged in any trade, business, or occupation for the manufacture or production of artificial silk or Viscose, or of any material, goods, or articles from Viscose in any form, nor enter into the service of or, directly or indirectly, assist or act for any person, firm, or corporation in such trade or business or manufacturing or contemplating the manufacture of artificial silk, without the express written consent of the said Company.

In Witness Whereof, The Viscose Company has caused its corporate seal to be hereunto affixed and the said Samuel Agar Salvage has hereunto set his hand and seal the day and year first above written.

THE VISCOSE COMPANY,
By NELSON S. SPENCER,
*Chairman of the Board of Directors.*

A. G. DICKSON.
Attest:

CHAS. E. HENDRIXSON,
*Secretary.*

SAMUEL AGAR SALVAGE. [SEAL]

103 PETITIONER'S EXHIBIT No. 8

[Copy]

DECEMBER 30TH, 1922.

THE VISCOSE COMPANY,
*Marcus Hook, Penna.*

GENTLEMEN: Referring to my purchase from you of 1,500 shares of your capital stock at par and to my agreement to procure for you for repurchase, certain portions thereof during the years 1923 to 1927, inclusive, I beg to say that I desire to exchange such shares of your stock for shares of American Viscose Corporation of Delaware at the rate of one share of your stock for four shares of the preferred and five shares of the common stock of said Delaware Company. If you will consent to my making such exchange, I will deliver to you certificates for the shares of the Delaware Company, which I will receive in exchange for the shares of your Company which you are entitled under my agreement to repurchase, and I agree that such shares of the stock of the Delaware Company shall be in all respects substituted for the shares of your own stock, to which said agreement applied, each four shares of preferrd stock and five shares of common stock of said Delaware Company to take the place of one share of your capital stock.

This letter and your written assent thereto shall constitute the contract.

Very truly yours,

SAMUEL A. SALVAGE.

104 PETITIONER'S EXHIBIT No. 4

THE VISCOSE CO.,
*Marcus Hook, Pa., December 30, 1922.*

Mr. S. A. SALVAGE,
*171 Madison Avenue, New York City.*

DEAR SIR: We acknowledge receipt of your letter of December 30th, 1922, in reference to proposed exchange by you of shares of our capital stock for shares of preferred and common stock of American Viscose Corporation of Delaware, and we hereby consent to such exchange and to the substitution of such preferred and common shares of the Delaware Company in place of the shares of our capital stock covered by your agreement with us of December 30th, 1922. We also agree to release and return to you at the end of the year 1923, one-fifth of the shares so deposited with us, provided that during said year 1923 we have not exercised our right to purchase, and we similarly agree, at the end of each of the years 1924, 1925, 1926, and 1927, to make release and return to you one-fifth of said shares, upon the same proviso.

Very truly yours,

THE VISCOSE COMPANY,
By NELSON S. SPENCER,
*Chairman of the Board of Directors.*

105 PETITIONER'S EXHIBIT No. 5

Memorandum of Agreement made and concluded this Second day of January 1922 between The Viscose Company, a corporation of the State of Pennsylvania, hereinafter called "The Company", of the one part, and Samuel Agar Salvage, of the City of New York, hereinafter called "Salvage", of the other part,

Witnesseth:

1. Salvage shall, for the period of six (6) years from the first day of January 1922, inclusive, act as Manager in New York of so much of the Company's business as relates to the sale and disposal in the United States of Viscose and Filamentary and other material, goods, and articles manufactured by the Company.

2. Except as next hereinafter provided, Salvage shall during the said period, devote his whole time, energies, and attention to the business, as aforesaid, of the Company, and shall not hold or be engaged in any office or employment with or on behalf of any other Company, firm, or person, or be engaged in or carry on any other business.

3. Salvage shall be at liberty to give such part of his time and attention, as he may at his absolute discretion think necessary, to the business of Lustre Fibres, Limited, under an agreement proposed to be entered into between that Company and him, and to be and to act as a Director of The Viscose Company, and to retain for
106 his own benefit all fees and moneys payable by either Company to him for his services.

4. Salvage shall in all respects conform to and carry out the instructions from time to time given by the Company or its Board of Directors, and shall prepare and furnish all such reports and accounts in relation to the Company's business, and give all such information in reference to such business as may from time to time be required by them respectively, and he shall well and faithfully serve the Company and use his utmost endeavors to promote the interests thereof.

5. The Company will pay to Salvage as remuneration a salary at the rate of Ten thousand dollars ($10,000) per annum for the year 1922, and Twenty-one thousand four hundred dollars ($21,400) per annum for the years 1923, 1924, 1925, 1926, and 1927, payable by equal monthly instalments on the last day of each calendar month; and a commission at the rate of two-thirds of one percent per annum on the net profits in each year of his engagement derived by the Company from its manufacture in the said United States of Viscose and Filamentary and other material, goods and articles, calculated on the same basis as has been customary between the parties hereto.

6. The certificate of the Auditors for the time being of the Company as to the amounts of the said net profits and commission shall be binding and conclusive on each of the parties hereto, and the said commission shall be paid in accordance with such cer-

107 tificate within three months after the thirty-first day of December of the year in respect of which the same is payable.

7. If, by reason of ill health, accident or otherwise, Salvage shall be incapacitated from properly attending to business for three consecutive calendar months, the Company may determine his engagement by three calendar months' notice in writing.

8. If Salvage shall become bankrupt or insolvent, or if he shall wilfully neglect or refuse to perform or observe any of the duties or obligations devolving upon him under this agreement, or shall otherwise commit a breach of any of the stipulations hereof, the Company may determine his engagement forthwith.

9. If any dispute or difference shall arise between the parties hereto, or their assigns or personal representatives, as to this agreement or the construction hereof, or of any clause herein contained, or the rights, duties or liabilities or either party hereunder, the same shall be referred in the said United States to three disinterested persons as Arbitrators; one to be appointed by each party, and the third by the two first appointed before they enter on the arbitration. The decision of the two first appointed, or, if they disagree, of any two of the three shall be final and binding on the parties hereto, and each of such parties shall pay one-half the expense of the arbitration.

10. Any notice hereunder may be served upon the Company
108 by leaving the same for or sending the same by registered post to the Company at its registered office for the time being, and upon Salvage by leaving the same for or sending the same by registered post to Salvage at his usual or last known place of abode or business, and any notice to Salvage shall be sufficient if signed by one Director of the Company. Every notice shall be deemed to have been served on the day of its being so left or on the day when in the ordinary course of post it would be delivered as the case may be.

11. The Company shall be entitled at any time during the said engagement to sell or dispose of, assign, and transfer this agreement, and all the Company's rights and liabilities thereunder to any existing or future Company or individuals, either alone or jointly with the Company, and to enter into any contract or contracts, and carry out any which may now or hereafter exist for or in relation to or in connection with any sale, disposal, assignment or transfer on the reconstruction of the Company or otherwise howsoever. Provided always that any such sale, disposition, assignment or transfer as aforesaid shall not take effect unless and until the assignee or transferee, as the case may be, shall, without expense to Mr. Salvage, have delivered to him a valid agreement with him to carry into full effect this agreement so far as the same may remain to be performed by the Company, and unless and until all moneys payable hereunder to Salvage to the date of such delivery shall have been paid or sufficiently secured.

In Witness Whereof, the Company hereunto causes its Com-
109 mon or Corporate Seal to be affixed, and Salvage hereunto sets his hand and seal the day and year above written.

SAMUEL AGAR SALVAGE.

The Common or Corporate Seal of The Viscose Company was hereunto affixed in the presence of A. G. Dickson, Nelson S. Spencer.

Signed, Sealed, and Delivered by the above-named Samuel Agar Salvage in the presence of A. G. Dickson, Nelson S. Spencer.

Between The Viscose Company and Samuel Agar Salvage

Agreement of service

Dated:

DICKSON, REITLER & MCCOUCH,
*Attorneys at Law,*
*No. 750 Bullitt Building, Philadelphia.*

110 PETITIONER'S EXHIBIT NO. 6 FOR IDENTIFICATION

Memorandum of agreement made and concluded this second day of Jan. 1922, between The Viscose Company, a corporation of the State of Pennsylvania, hereinafter called "The Company", of the one part, and Charles Augustus Ernst, of Ridley Park, Delaware County, Pennsylvania, hereinafter called "Ernst", of the other part,

Witnesseth:

1. Ernst shall, for the period of six (6) years from the first day of January 1922, inclusive, act as Manager of all of the Company works in the United States of America.

2. Ernst shall at all times during the ordinary hours of business of the Company employ himself in the conduct and transaction of all matters and things connected with his said employment which shall fall within his duties in the capacity aforesaid or which the Company may from time to time assign to him as the same respectively may from time to time by defined by the Company, and shall exercise all the powers from time to time vested in him by the Company.

3. Ernst shall at all times whilst in the said employment have regard to and observe and comply with all reasonable regulations and directions which may from time to time be made or given by the Company in relation to the Company's business and the management of its affairs, his duties as Manager and otherwise.

4. Ernest shall not whilst in the employment of the Com-
111 pany or at any time thereafter without the Company's previous consent, divulge to any person, firm, or corporation, whatsoever, information as to any process, machinery, materials, chemicals, business concerns, and affairs of the Company or used or intended to be used by the Company which he now possesses or which hereafter whilst in the said employment he may obtain or acquire and for the

purpose of this Agreement all information which he now possesses or which hereafter whilst in such employment he may obtain or acquire as to any of the said processes, machinery, materials, chemicals, business concerns, and affairs shall be deemed to have been obtained and acquired whilst in the employment of the Company. Ernst shall at all times hereafter keep secret all information in reference to the matters aforesaid and every of them which he now possesses or which at any time hereafter whilst in such employment he may obtain or acquire.

5. Ernst shall at all times during the employment aforesaid diligently and faithfully and to the best of his skill and ability endeavor to discover and invent and procure information as to or respecting improvements and the defects in the processes, machinery, materials, and chemicals aforesaid and the remedies for such defects and as to and respecting new processes, machinery, materials, and chemicals suitable for use in the Company's business. If any such improvement, remedy, discovery, invention or information is now known to Ernst or at any time hereafter whilst in the Company's employment shall become known to or made or obtained by him, he shall
112 forthwith communicate the same to the Company and he shall not whilst in the said employment or at any time thereafter without the Company's previous written consent, divulge the same to any person, firm or corporation.

6. All discoveries and inventions connected with the business of the Company made by Ernst while he is in the Company's employment, whether patented or protected or not, and all patents or other protections for or in respect of the same respectively, whether such patents or protections be obtained during or after such employment and the full benefit of the same discoveries, inventions, patents and protections shall belong to and shall be and shall remain the property of the Company absolutely, and Ernst shall at all times both during and after such employment, upon the request and at the expense of the Company, do whatever the Company reasonably requires for giving full effect to this clause, including all such things as may be necessary to enable the Company in the United States of America, Canada, or any other country, to apply for and obtain as and in such names and in such manner as may be required by the Company, such provisional or other protection or Letters Patent respectively, as the Company may desire, and shall when the same shall have been obtained forthwith when required assign the same to the Company or as the Company shall direct.

7. If Ernst shall at any time during the said employment know or make or believe that he knows of or has made any such improvement, remedy, discovery or invention as aforesaid, as shall forthwith communicate the same or his idea or ideas to the Company and to the extent and in the manner authorized by the Company and
113 no further, or otherwise he shall be at liberty to continue and carry out any experiments or work in connection with or for perfecting the same.

8. The Company will pay to Ernst as remuneration a salary at the rate of $17,000 per annum for the year 1922, payable by equal monthly instalments on the last day of each calendar month, and at the rate of $33,200 per annum for the years 1923, 1924, 1925, 1926, and 1927, payable in equal monthly instalments on the last day of each calendar month, and a commission at the rate of 1% per annum on the net profits and income of the Company in each year of his employment derived by the Company from the Company's manufactures, investments, and properties in the United States, calculated on the same basis as has been customary between the parties hereto. The said commission shall be payable yearly within two calendar months after the 31st day of December of the year for which the same shall be payable.

9. If required, a certificate of the Company's Auditors as to the amount payable for commisson shall be furnished, and the same shall be final and conclusive for all purposes, and Ernst shall not in connection with the amount so payable be entitled to require or to have inspection or copies of or extracts from or information in relation to the Company's accounts, books, documents, profits, receipts, payment, outgoing business or affairs, or to prescribe the mode in which any account shall be kept or how any moneys, matter, or thing shall be dealt with, or to interfere in any of the matters aforesaid in any way whatsoever.

114 10. If by reason of ill health, accident, or otherwise, Ernst shall be incapacitated from properly attending to business for three consecutive calendar months, the Company may determine his engagement by three calendar months' notice in writing.

11. If Ernst shall become bankrupt or insolvent, or if he shall wilfully neglect or refuse to perform or observe any of the duties of obligations devolving upon him under this agreement, or shall otherwise commit a breach of any of the stipulations hereof, the Company may determine his engagement forthwith.

12. Any such notice by the Company as in this Agreement mentioned shall be sufficient if it is signed by a Director of the Company and sent by post to the usual or last known place of abode of Ernst, and such notice if so sent shall be deemed to have been given at the expiration of twelve hours after it should have been received in the ordinary course of post.

13. If at any time during the said employment the Company shall sell or dispose of to any now existing or any future corporation or firm, or to any individuals exceeding two in number, the Company's Works and business or shall enter into any contract for any such sale or disposition or into voluntary liquidation or similar proceedings with a view to reconstruction, the Company shall be entitled to assign and transfer, and to contract to assign and transfer, this Agreement and all the Company's rights and liabilities accordingly, and from and after any such assignment and the transfer as aforesaid and such agreement and payment as hereinafter

115 respectively mentioned, this Agreement shall be read and construed in all respects as if the name of the Assignee or Transferee had been inserted in this Agreement throughout instead of the name of the Company, Provided always that any such assignment or transfer as aforesaid shall not take effect unless and until the Assignee or Transferee, as the case may be, shall without expense to Ernst have delivered to him a valid Agreement with him to carry into full effect this Agreement so far as the same may remain to be performed by the Company and unless and until all moneys payable hereunder to Ernst to the date of such delivery shall have been paid or sufficiently secured.

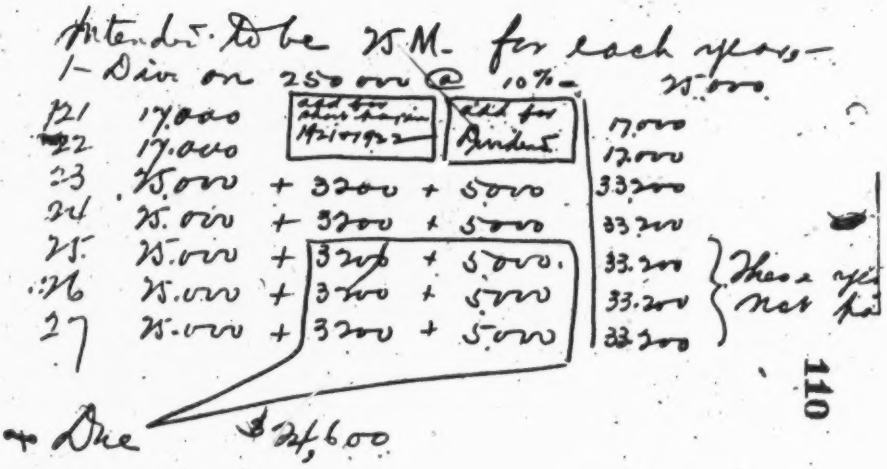
In Witness Whereof, The Viscose Company hereunto causes its Common Seal to be affixed and the said Charles Augustus Ernst hereunto sets his hand and seal the day and year first above written.

CHARLES AUGUSTUS ERNST.

The Common Seal of The Viscose Company above named was hereunto affixed in the presense of A. G. Dickson, Nelson S. Spencer.

Signed, Sealed, and Delivered by the above-named Charles Augustus Ernst in the presence of Edward Hopkinson, Jr., A. G. Dickson, Nelson S. Spencer.

116



117 C. A. ERNST

*v.*

THE VISCOSE CO.

Service agreement Jan. 1/22 for 6 Years.

DICKSON, BEITLER & MCCOUCH,
*Attorney at Law,*
*No. 750 Bullitt Building, Philadelphia.*

PETITIONER'S EXHIBIT No. 7

Memorandum of Agreement made this 23d day of December, A. D. 1913, by and between Courtaulds, Limited, a corporation organized and existing under the laws of Great Britain, hereinafter called "first party", and American Viscose Company, a corporation organized and existing under the laws of the Commonwealth of Pennsylvania, hereinafter called "second party."

Whereas second party is engaged in manufacturing artificial
118 silk and in such business has found it expedient and profitable to make use of certain patents, improvements, and processes which were the property of Samuel Courtaulds & Company, Limited, but which by assignment and transfer passed as of January 1st, 1913, to and are now the property of said first party and

Whereas no payment has yet been made for such use for the year 1913, and

Whereas the parties hereto have agreed upon the terms hereinafter set forth as constituting a fair and equitable price for the sale and purchase of the license and rights hereinafter referred to.

Now This Agreement Witnesseth:

First. Courtaulds, Limited, will, subject to all existing rights (if any), sell, grant, convey, assign, transfer, and set over to second party the right, privilege, and license as from the said first day of January 1913 and thenceforth, during the years 1913, 1914, 1915, and 1916, to use in the United States all the patents, improvements, and processes which it now owns relating to the manufacture of artificial silk and, so far as it is able to do so, the right, privilege, and license to use in the United States such patents, improvements, and processes relating to the manufacture of artificial silk as first party owns in connection with others, whose consent thereto is or may be necessary.

Second: First party also agrees during the aforesaid period to
119 give to second party the fullest information and disclosure as to all machinery, processes, secret or otherwise, for or in reference to the manufacture of artificial silk and to extend to second party full inspection from time to time as desired of its several factories.

Third. Second party agrees that first party may during said period use all patents, improvements, and processes for the manufacture of artificial silk, which second party may discover, invent, obtain, or otherwise acquire and that during said period it will give to first party the fullest information and disclosure as to all machinery, processes, secret or otherwise, and extend to first party full inspection from time to time of its factories as may be desired.

Fourth. Second party further agrees that it will not assign without the consent of first party in writing first had and obtained any of the rights or privileges under this agreement and agrees that any assignment by operation of law or otherwise without such prior written consent by first party shall be void and second party further agrees to keep all information obtained by it under or in the exercise of the rights aforesaid absolutely secret, except only to the extent actually necessary in connection with the manufacture of artificial silk in the United States by the second party and not at any time during the aforesaid period or thereafter except for the purpose aforesaid to disclose the same to any person or corporation without such previous consent in writing of the first party.

Fifth. Second party agrees to pay to first party First: the sum of $2,000,000, as follows:

120 (a) $500,000 each on the last days of December of the years 1913, 1914, 1915, and 1916, except that the first of said payments shall be postponed until the consent of the stockholders of second party, authorizing an increase of its indebtedness has been given, said payments to be made in London, England, together with interest at the rate of six percent per annum on the amount from time to time remaining unpaid from January 1, 1913, payable semi-annually in London, England, on the last days of June and December in each of said years, and Secondly:

(b) A sum or sums equal to the percentages of the profits of its business hereinafter stated, as ascertained prior to the deduction of the said $2,000,000 or any part thereof or the interest thereon respectively, and if such payments should in any way be construed to be subject to the United States Income Tax and as said second party may be permitted by law to pay the same, second party agrees to make said payments free from any deduction for said tax:

For the year 1913, a sum equal to 18% per annum;
For the year 1914, a sum equal to 16% per annum;
For the year 1915, a sum equal to 14% per annum;
For the year 1916, a sum equal to 12% per annum.

Sixth. Second party further agreed that upon demand of
121 first party it will execute and deliver notes or debentures representing the payments to be made as hereinabove provided or such of them as may be required, said notes or debentures to bear date January 1st, 1913, and to take all such steps as it may be advised by counsel learned in the law are or shall be necessary

for making such notes or debentures valid and binding obligations of the second party.

For COURTAULDS, LIMITED,
(Signed) H. GEO. RUSHBROOK.
AMERICAN VISCOSE CO.,
(Signed) F. S. YOUNGHUSBAND,
*Treasurer.*

PETITIONER'S EXHIBIT No. 8

Memorandum of Agreement Made this 20th day of May 1915, by and between Courtaulds, Limited, a Corporation organized under the laws of Great Britain, hereinafter called Courtaulds, and which term wherever the context so admits or allows, shall include its designs, of the one part, and American Viscose Company, a Corporation organized under the laws of Pennsylvania, in the United States of America, hereinafter called Viscose, of the other part.

Whereas Courtaulds is the owner of the United States Patents and Applications for Patents, and which with the Patents granted on such Applications, are hereinafter called the said Patents, mentioned and set forth in the Schedule hereto, for certain Im-
122 provements, machinery, and Processes relating to the manufacture of Artificial Silk, and

Whereas Viscose is engaged in the manufacture of Artificial Silk, and desires to purchase the said Patents, and

Whereas the parties hereto have agreed upon the terms hereinafter set forth as constituting a fair and proper arrangement for such sale and purchase,

Now This Agreement Witnesseth:

1. Courtaulds will sell, and Viscose will buy, all the right, title, and interest of Courtaulds, of, in, and to the said Patents, subject to all existing rights (if any), and the same shall be transferred to Viscose, or to The Viscose Company, hereinafter referred to as its Nominee, as Viscose may direct, by such deeds, assignments, and assurances, and containing all such powers, provisions, and otherwise as Counsel shall advise to be necessary and proper.

2. Courtaulds agrees that, during the life of such one of the said Patents as shall longest continue, Viscose, or its nominee, may, in the United States, use all Patents, Improvements, Machinery, and Processes in and for the manufacture of Artificial Silk, which Courtaulds may now or hereafter own, discover, invent, obtain, or acquire, and that, during the period aforesaid, Courtaulds will, to the extent of its knowledge, give to Viscose, or its Nominee, the fullest information and disclosure as to all machinery and processes, secret
123 or otherwise, in reference to such manufacture, and extend to Viscose, or its Nominee, full inspection from time to time of its factories for such manufacture.

3. Viscose agrees that, during the life of such longest lived Patent, Courtaulds may use all Patents, Improvements, Machinery, and Processes in and for the manufacture of Artificial Silk, which Viscose, or its Nominee, may now or hereafter own, discover, invent, obtain or acquire, and that, during the period aforesaid, Viscose, or its nominee, will, to the extent of its knowledge, give to Courtaulds the fullest information and disclosure as to all machinery and processes, secret or otherwise, in reference to such manufacture, and extend to Courtaulds full inspection from time to time as desired of its factories.

4. The consideration for the said sale and purchase shall be $5,000,000.00, to be satisfied by the payment of $500,000.00 on December 31st of the year 1915, and a like sum on the same day of each year thereafter to and including the year 1924, in London, England, together with interest at the rate of six percent per annum from and including May 20th, 1915, on the said sum of $5,000,000.00, or the amount thereof from time to time remaining unpaid, payable semiannually in London, England, on the last days of June and December of each of the said years 1915 to 1924 inclusive.

5. Each of the said sums of $500,000.00 shall be secured by a Note, Debenture or Obligation of the Assignee of the said Patents, in such form and containing all such powers and provisions
124 as Courtaulds shall be advised by Counsel to be necessary and proper, including provisions that, if default is made in payment of any of the said sums or interest at the times and in manner aforesaid, and the amount due and unpaid shall not be paid within one calendar month after receipt of notice, in writing, from Courtaulds, requiring said payment, then the whole of the said sum of $5,000,000.00, or so much thereof as may for the time being remain unpaid, and interest shall become and be immediately payable.

6. If any of the payments hereinbefore mentioned shall in any way be construed to be subject to United States Income Tax, and as Viscose, or its Nominee, may be permitted by law to pay the same, Viscose agrees for itself, and its Nominee, that the Assignee of the said Patents shall make the said payments free from any deduction for or in respect of the said tax.

7. If, pursuant to the direction of Viscose, as aforesaid, the said Patents shall be assigned to The Viscose Company, and that Company shall thereon execute and deliver to Courtaulds such Notes, Debentures or Obligations, as aforesaid, then, thereupon, all liability of Viscose for satisfaction and payment of the said sum of $5,000,000.00 and interest, and every part thereof, respectively, shall absolutely cease and determine.

8. If the said sale and purchase shall not be completed on or before July 1st, 1915, or other date agreed in writing by the parties hereto, this agreement shall be at an end.

In witness whereof the parties hereto cause their Common or Corporate Seals to be hereunto affixed,

125 The Schedule hereinbefore referred to.

(1) Filament for Incandescent Electric Lamps, by C. H. Stearn, Pat. 622,087, March 28, 1899;

(2) Apparatus for Production of Filaments, by C. F. Topham, Pat. 702,382, June 10, 1902;

(3) Process of Manufacturing Filaments from Cellulose, by C. H. Stearn, Pat. 716,778, December 23, 1902;

(4) Manufacture of Filaments, etc., by Stearn and Woodley, Pat. 725,016, April 7, 1903;

(5) Apparatus for Artificial Silk, by Ryon and White, Pat. 732,784, June 7, 1903;

(6) Manufacture of Filaments, by C. N. Waite, Pat. 759,332, May 10, 1904;

(7) Purifying Viscose, by C. F. Cross, Pat. 763,266, June 21, 1904;

(8) Manufacturing Viscose, by C. N. Waite, Pat. 791,385, May 30, 1905;

(9) Viscose-Coated Fiber and Process, by C. N. Waite, Pat. 791,386, May 30, 1905;

(10) Manufacturing Filaments from Viscose, by C. A. Ernst, Pat. 792,888, June 30, 1905;

(11) Manufacturing Filaments from Viscose, by C. A. Ernst, Pat. 796,027, August 22, 1905;

(12) Bleaching Artificial Silk, by C. A. Ernst, Pat. 805,456, November 28, 1905;

(13) Forming Filaments, by C. A. Ernst, Pat. 808,148, December 26, 1905;

(14) Apparatus for Forming Filaments, by C. A. Ernst, Pat. 808,149, December 26, 1905;

(15) Manufacture of Filaments, by C. N. Waite, Pat. 816,404, March 27, 1906;

(16) Spinning Head, by M. Waddell, Pat. 823,009, June 12, 1906;

(17) Apparatus for Spinning Filaments, by M. Waddell, Patent 846,879, March 12, 1907;

126 (18) Apparatus for Forming Filaments, by M. Waddell, Pat. 849,822, April 9, 1907;

(19) Manufacture of Filaments, by C. N. Waite, Pat. 849,823, April 9, 1907;

(20) Apparatus for Forming Filaments, by M. Waddell, Pat. 849,870, April 9, 1907;

(21) Manufacture of Viscose, by M. Waddell, Pat. 855,213, May 28, 1908;

(22) Spinning Head, by C. A. Ernst, Pat. 858,648, July 2, 1907;

(23) Reeling Threads, by M. Waddell, Pat. 863,766, August 20, 1907;

(24) Forming Filaments, by C. A. Ernst, Pat. 863,793, August 20, 1907;

(25) Machine for Twisting, by M. Waddell, Pat. 867,623, October 8, 1907;

(26) Producing Filaments, by C. A. Ernst, Pat. 876,533, January 14, 1908;

(27) Filtering Viscose, by C. A. Ernst, Pat. 876,901, January 14, 1908;

(28) Forming Filaments, by C. A. Ernst, Pat. 896,715, August 25, 1908;

(29) Apparatus for Winding Reels, by J. Clayton, Pat. 967,730, August 16, 1910;

(30) Manufacture of Threads, etc., by L. P. Wilson, Pat. 970,589, September 20, 1910;

(31) Apparatus for Manufacture of Artificial Silk, etc., by J. Clayton, Pat. 979,434, December 27, 1910;

(32) Manufacture of Filaments, by S. S. Napper, Pat. 1,045,731, November 26, 1912;

(33) Regeneration of Sulphides, by L. P. Wilson, Pat. 1,106,266, August 4, 1914;

(34) Bleaching Apparatus, by J. Clayton, Pat. 1,116,242, November 3, 1914;

(35) Improvements in the Manufacture and Production of
127 Cellulose Compounds, by W. H. Glover and L. P. Wilson, Patent Application, Serial Number 3830, filed January 22, 1915;

(36) Manufacture of Cellulose Compounds, by L. P. Wilson, Patent Application, Serial Number 3831, filed January 22, 1915.

(Sd.) For COURTAULDS, LIMITED,
H. GEO. RUSHBROOK,
*Secretary.*

(Seal of Am. Vis. Co.)

The Common or Corporate Seal of American Viscose Company was hereunto affixed in the presence of

(Sd.) H. GEO. RUSHBROOK,
ARTHUR G. DICKSON,
*Directors.*

Duplicate Executed Original of Agreement Relating to Patents, May 20, 1915.

COURTAULDS, LIMITED,
and
AMERICAN VISCOSE COMPANY,
DICKSON, BEITLER & MCCOUCH,
*Attorneys at Law,*
*No. 750 Bullitt Building, Philadelphia.*

1456

Form 843
TREASURY DEPARTMENT
Internal Revenue Service
Revised June, 1929

# CLAIM

TO BE FILED WITH THE COLLECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID

Lac-Sou-77

The Collector will fill in the blank below the kind of claim filed, and fill in the certificate on the reverse side.

[X] Refund of Tax Illegally Collected.
[ ] Refund of Amount Paid for Stamps Unused, or Used in Excess or Error.
[ ] Abatement of Tax Assessed (not applicable to estate or income taxes).

RECEIVED
MAR 14 1932
CLAIMS CONTROL SECTION

COLLECTOR'S STAMP
(Date received)
RECEIVED
MAR 14 1932

STATE OF New York
CITY OF New York } ss:

TYPE OR PRINT

Name of taxpayer or purchaser of stamps SAMUEL A. SALVAGE

Business address 200 Madison Avenue, New York City.
(Street) (City) (State)

Residence Glen Head, Long Island, New York.

I, ..., being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed Brooklyn, N. Y.
2. Period (if for income tax, make separate form for each taxable year) from Jan. 1, 1929, to Dec. 31, 1929.
3. Character of assessment or tax Income
4. Amount of assessment, $126,755.72; date or dates of payment quarterly during 1930.
5. Date stamps were purchased from the Government ... $ 55,750.00
6. Amount to be refunded ... $
Amount to be abated (not applicable to income or estate taxes) ... $
7. The time within which this claim may be legally filed expires, under Section 322 (b) 1 of the Revenue Act of 1926, on March 15, 1932.

The taxpayer verily believes that this claim should be allowed for the following reasons:

1. The taxpayer claims that the tax assessed against him and paid by him upon an alleged gain derived from the redemption at $110. per share of 6,000 shares of the preferred stock of American Viscose Corporation should be refunded by reason of the fact that he received said 6,000 shares of preferred stock on or about December 20th, 1922, as the result of a consolidation of The Viscose Company and said American Viscose Corporation; that he had purchased 1,500 shares of the stock of The Viscose Company at $100 per share on that date and that said stock of The Viscose Company upon the date of the purchase had a value greatly in excess of the amount paid therefor, which value has been found by the Government to have been $1,164.70 per share; that taxpayer was an officer of The Viscose Company, and in effect, in purchasing the stock of said company, at $100. per share, was receiving as additional compensation the difference between said $100. per share and the real value of said stock; that such difference in value could not be taxed in the year 1929.

2. The taxpayer further claims that the preferred stock of the American Viscose Corporation received by him in 1922 upon the consolidation of the two companies was in fact a dividend upon the stock of The Viscose Company held by him and was not in any way taxable in 1929. He therefore claims that there should be refunded to him the entire amount of the tax paid by him upon the alleged gain derived from the redemption of said stock, and he further claims that the additional assessment levied against him by reason thereof should be abated.

a1

1238 129

TREASURY DEPARTMENT
Internal Revenue Service
Washington, D.C.

# CLAIM

TO BE FILED WITH THE COLLECTOR WHERE AGREEMENT WAS MADE OR TAX PAID

Boston 77

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on reverse side.

COLLECTOR'S STAMP

RECEIVED
MAR 14 1932
CLAIMS CONTROL SECTION

RECEIVED

- [X] REFUND OF TAX ILLEGALLY COLLECTED.
- [ ] REFUND OF AMOUNT PAID FOR STAMPS UNUSED, OR USED IN ERROR OR EXCESS.
- [ ] ABATEMENT OF TAX ASSESSED (not applicable to estate or income taxes).

STATE OF New York
COUNTY OF New York } ss:

TYPE OR PRINT

Name of taxpayer or purchaser of stamps SAMUEL A. SALVAGE

Business address 200 Madison Avenue, New York City.
(Street) (City) (State)

Residence Glen Head, Long Island, New York.

I, deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed Brooklyn, N. Y. 1 NY 1929
2. Period (if for income tax, make separate items for each taxable year) from Jan. 1 1929, to Dec. 31 1929
3. Character of assessment or tax Income
4. Amount of assessment, $ 120,755.78; date of payment quarterly during 1929.
5. Date stamps were purchased from the Government
6. Amount to be refunded $ 55,750.00
7. Amount to be abated (not applicable to income or estate taxes) $
8. The time within which this claim may be legally filed expires, under Section 322 (b) 1 of the Revenue Act of 1928, March 15 1932.

Samuel A. Salvage

Sworn to and subscribed before me this 8 day of March 1932.

Notary Public

Collector, Dist. of N.Y.

Dec. 30, 1932

130

## CERTIFICATE

I certify that an examination of the records of this office shows the following facts as to the assessment and payment of the tax:

| Character of assessment and period covered | List | Year | Month | Assessed, on | | Amount assessed | | Paid, dimin. or Overpaid | | | Date of payment |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Page | Line | | | Date | Amount | | |
| Income | Reg | 1920 | Oct. | 30 | 1577 | $ 178,258 | 76 | 3/6/20 | $ 30,188 | 93 | Pd |
| 1919 | | " | " | | | | | 6/5/20 | 30,188 | 93 | Pd |
| | | | | | | | | 9/10/20 | 30,188 | 93 | Pd |
| | | | | | | | | 12/15/20 | 30,188 | 94 | Pd |
| | | | | | | | | | | | |
| | | | | | | | | | | | |
| | | | | | | | | | | | |
| | | | | | | | | | | | |
| | | | | | | | | | | | |
| | | | | | | | | | | | |
| | | | | | | | | | | | |
| | | | | Total | | $ 178,258 | 76 | Total | $ 120,755 | 04 | |

Claim No.

I certify that the records of this office show the following facts as to the purchase of stamps:

| To whom sold or issued | Kind | Number | Denomination | Date of sale or issue | Amount | If spoiled or stamp, date | |
|---|---|---|---|---|---|---|---|
| | | | | | | Serial number | Initial and date |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |
| | | | | | | | |

Collector of Internal Revenue.

By ____, Deputy.

COMMITTEE ON CLAIMS

Claim examined by:

Approved by:

Chief of Division.

Amount claimed... $ ____

Amount allowed... $ ____

Amount rejected... $ ____

### INSTRUCTIONS

1. The claim must set forth in detail and under oath each ground upon which it is made, and facts sufficient to apprise the Commissioner of the exact basis thereof.

2. The claim shown, or errors to be by the taxpayer if possible. Whenever it is necessary to have the claim executed by an attorney or agent, on behalf of the taxpayer, an authenticated copy of the document specifically authorizing such agent or attorney to sign the claim on behalf of the taxpayer shall accompany the claim. The oath will be administered without charge by any collector, deputy collector, or internal revenue agent.

3. If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased, certified copies of the letters testamentary, letters of administration, or other similar evidence must be annexed to the claim, to show the authority of the executor, administrator, or other fiduciary by whom the claim is filed. If no executor, administrator, guardian, trustee, or other fiduciary files a return and thereafter refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made on the claim showing that the return was filed by the fiduciary and that the power is still existing.

4. Where the taxpayer is a corporation, the claim shall be signed with the corporate name, followed by the signature and title of the officer having authority to sign for the corporation.

131 In United States Circuit Court of Appeals for the Second Circuit

[Title omitted.]

*Praecipe for record*

Filed Aug. 22, 1934

You will please prepare, transmit, and deliver to the Clerk of the United States Circuit Court of Appeals for the Second Circuit copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Second Circuit heretofore filed by the Commissioner of Internal Revenue.

1. Docket entries of the proceedings before the Board.
2. Pleadings before the Board.
(a) Petition, including annexed copy of deficiency letter.
(b) Answer.
3. Stipulation of facts filed at hearing on the 7th day of December, 1933.

132 4. Memorandum opinion and decision of the Board.

5. Petition for review, together with proof of service of notice of filing petition for review and of service of a copy of petition for review.

6. Statement of evidence as settled and allowed, together with all exhibits, being Petitioner's Exhibits one (1) to eight (8), inclusive, attached to deposition, and Petitioner's Exhibit one (1) offered and received in evidence at the hearing on December 7, 1933.

7. Orders enlarging time for the preparation of evidence and for the transmission and delivery of the records not included in record.

8. This praecipe.

GEORGE B. BROOKS,
*Attorney for Petitioner.*

Service of a copy of the foregoing praecipe is hereby acknowledged this 22nd day of August 1934. The privilege of filing a counter praecipe is hereby waived.

ROBERT H. JACKSON,
*Assistant General Counsel for the Bureau of Internal Revenue,*
*Attorney for Respondent.*

tco.

8-22-34.

133 [Clerk's certificate to foregoing transcript omitted in printing.]

134 In United States Circuit Court of Appeals for the Second Circuit

SAMUEL A. SALVAGE, PETITIONER

*vs.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Before L. HAND, SWAN, and AUGUSTUS N. HAND, Circuit Judges

John G. Jackson, George B. Brooks, for petitioner.
Frank J. Wideman, Assistant Attorney General; Sewall Key, Helen R. Carloss, Special Assistants to the Attorney General, for respondent.

*Memorandum opinion*

PER CURIAM: A reargument is ordered limited to the following point arising upon the claim for refund: If the court should accept the Board's finding that The Viscose Company shares issued to the petitioner on December 30, 1922, were not to be considered as compensation for services, is he nevertheless entitled to the claimed refund on the theory that Article 31, Regulation 65, covers a case where the consideration given for the stock is a covenant not to engage in a competing business?

135 The case will be set for reargument on February 18, 1935.

The appellant's brief shall be filed on or before February 8th, the respondent's on or before February 18th.

L. H.
T. W. S.
A. N. H.

136 In United States Circuit Court of Appeals for the Second Circuit

No. 153. October term, 1934

Argued Dec. 20, 1934. Reargued Feb. 18, 1935. Decided March 18, 1935

SAMUEL A. SALVAGE, PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from the Board of Tax Appeals

Before L. HAND, SWAN, and AUGUSTUS N. HAND, Circuit Judges

Petition for review of an order of the United States Board of Tax Appeals. From an order determining a deficiency in income taxes for the year 1929, the taxpayer appeals. Reversed.

John G. Jackson and George B. Brooks, both of New York City, for petitioner.

Frank J. Wideman, Asst. Atty. Gen., and Sewall Key and Helen R. Carloss, Sp. Assts. to Atty. Gen., for respondent.

*Opinion*

SWAN, *Circuit Judge:* The Board decreed a deficiency of $12,005.38 in the petitioner's income tax for the year 1929. He contends that not only is there no deficiency, but that he is entitled to a refund of $63,750. The controversy arises out of the fact that in 1929 the petitioner received $671,000 upon the redemption of 6,100 shares of preferred stock of American Viscose Corporation. The question in dispute is what part of this sum represents capital net gain, and this involves a determination of the cost base properly attributable to the redeemed shares.

In December 1922 the Viscose Company, of which the petitioner Salvage was an officer and employee, increased its capital stock by 4,000 shares and permitted Mr. Salvage to acquire 1,500 of them. They were sold to him at par, $100 per share, pursuant to a contract dated December 30, 1922, which recited that they were sold at less than their real value in consideration of the agreement of Salvage therein set forth. By the contract he agreed (1) that the corporation should have an option to repurchase at par five-sevenths of the 1,500 shares at any time during 1923, four-sevenths during 1924, three-sevenths during 1925, two-sevenths during 1926, and one-seventh during 1927; and (2) that he would not engage at any time throughout his life in any competing business without the company's consent. Another contract of the same date permitted him to exchange each of these 1,500 shares for four preferred shares and five common shares of American Viscose Corporation, and, with respect to the aforesaid option of repurchase, expressly substituted for each share of old stock subject to it an equivalent block of the new preferred and common. The option was never exercised in any year. In addition to the above-mentioned 1,500 shares of the Viscose Company, Mr. Salvage owned 25 shares which he had acquired in 1916 at a cost of $166.66 a share. There 25 shares he also exchanged for stock of American Viscose Corporation on the same basis of four preferred and five common for one share of the Viscose Company stock. Altogether he received 6,100 preferred and 7,625 common shares of American Viscose in exchange for his 1,525 shares of
137 Viscose stock. In 1929 his preferred shares, which were callable at $110 per share, were redeemed at the aggregate sum of $671,000. In his income-tax return for 1929 he reported as capital net gain the difference between $671,000 and the sum of $154,166.66 which he had paid for the 1,525 shares of Viscose stock. In auditing the return the Commissioner apportioned 37.778 percent of the petitioner's cost to the preferred stock and 62.222 percent to the common

stock. This resulted in ascribing to the 6,100 preferred shares a cost base of $58,123.47 and produced the deficiency in question.

Before the Board the petitioner contended, first, that he had made a "bargain purchase" of the 1,500 shares of the Viscose Company stock on December 30, 1922, that the fair market value of such stock on that date was $1,164.70 per share, and upon this basis no taxable gain was realized on redemption of the preferred shares, but, rather, there had been an overpayment of taxes; and, second, that it was impracticable to apportion the cost of the Viscose stock between the preferred and common shares of American Viscose so that no taxable gain was realized until the entire cost ($154,166.66) was recovered. The Board rejected both contentions.

It is conceded that the real value of Viscose stock on December 30, 1922, was $1,164.70 per share. The petitioner paid only $100 per share in cash, and the Commissioner concedes that the difference of $1,064.70 per share, if it had represented compensation for services, past or future, would have constituted taxable income to the petitioner in 1922, and that the market value of the stock when acquired would be the proper basis for determining gain upon the subsequent sale (or redemption) of any stock exchanged for it in a nontaxable exchange. T. D. 3435, later incorporated in article 31, Reg. 65. Said Treasury Decision, now part of the Regulations, reads as follows:

"Where property is sold by a corporation to a shareholder or member, or by an employer to an employee, for an amount substantially less than its fair market value, such shareholder or member of the corporation or such employee shall include in gross income the difference between the amount paid for the property and the amount of its fair market value. In computing the gain or loss from the subsequent sale of such property its cost shall be deemed to be its fair market value at the date of acquisition."

Although there is no suggestion in the language quoted that the property sold for less than its fair market value must be intended to be compensation to an employee for past or future services or in the nature of a dividend to a shareholder, the article has properly been so limited. Commissioner v. Van Vorst, 59 F. (2d) 677 (C. C. A. 9); Taplin v. Commissioner, 41 F. (2d) 454 (C. C. A. 6). In the Van Vorst Case the stockholder purchased real estate from his corporation at less than its market value, and the taxing officials attempted to include in his gross income the sum by which the market value of the land exceeded the price paid by the purchaser. This was not permissible, because such excess value was not "income" within the meaning of the applicable revenue act. The Taplin Case was a similar ruling where stock was purchased for less than its real value. But where the excess value is in the nature of compensation for services it does constitute taxable income when received. Robinson v. Commissioner, 59 F. (2d) 1008 (C. C. A. 6); Rodrigues v. Edwards, 40 F. (2d) 408 (C. C. A. 2). In the case at bar the Board

found that the stock was not acquired by the petitioner as compensation for services. The correctness of this finding is disputed, but, as it was made upon conflicting evidence, some of which tends to support it, we must accept it as a finding of fact.

Nevertheless the Commissioner is not aided thereby. The contract under which the petitioner purchased the 1,500 shares of Viscose stock stated that the consideration for selling it at less than its real value was the petitioner's covenants relating to the option and to his refraining from engaging in a competing business. Compensation paid for refraining from labor would seem to be taxable income no less than compensation for services to be performed. For example, a farmer who is paid for voluntarily refraining from raising hogs receives, in our opinion, income. Certainly it is neither a capital payment nor a gift. The statutory definition of gross income is exceedingly broad. Section 213, Revenue Act 1921 (42 Stat. 237). We cannot avoid the conclusion that a payment for a covenant not to engage in a certain business should be deemed "income" of the recipient of the payment. Cox v. Helvering, 63 App. D. C. 264, 71 F. (2d) 987, supports this view. See also Lihme v. Reinecke,
138 59 F. (2d) 633, 635 (C. C. A. 7). As to two-sevenths of the 1,500 shares, the petitioner acquired their full value on December 30, 1922. As to the rest, the Viscose Company still had a string upon them by virtue of its option. Until the option expired in subsequent years, the market value of the shares subject to it could scarcely exceed the price at which the company could repurchase them, namely, par. See Wilson v. Bowers, 57 F. (2d) 682, 683 (C. C. A. 2). We conclude, therefore, that Mr. Salvage made a "bargain purchase" of the 1,500 shares of Viscose stock acquired in 1922. Two-sevenths of the shares (428⅔) were not subject to the option and had a market value of $1,164.70 a share, a total of $499,157.14; five-sevenths (1,071⅓) had a market value of $100 per share, or $107,142.86. This gives a total market value for 1,500 shares of $606,300, and the cash consideration paid for them by Mr. Salvage was only $150,000. The difference was the "bargain" given him in return for his covenant not to compete. He did not, however, return it as income in 1922.

The Commissioner argues that the petitioner should be estopped to claim the basis prescribed by T. D. 3435, since he did not report the "bargain purchase" as income in 1922. The actual decision in Robinson v. Commissioner, 59 F. (2d) 1008 (C. C. A. 6), is opposed to this contention, although the point is not discussed in the opinion. Crane v. Commissioner, 68 F. (2d) 640 (C. C. A. 1), tends to support it, although the facts are somewhat different. See, also, Edward G. Swartz, Inc., v. Commissioner, 69 F. (2d) 633, 635 (C. C. A. 5). In the Crane Case, Judge Morton, in a concurring opinion, repudiated the theory of estoppel, and in our judgment makes the sounder argument. So far as appears, the petitioner's failure to report the income in 1922 was due to an innocent mistake of law; he made no

false representation of fact, and may, for all that this record discloses, have mentioned the purchase in his 1922 return. Under such circumstances we cannot find any adequate basis for an estoppel. See United States v. S. F. Scott & Sons, 69 F. (2d) 728, 732 (C. C. A. 1); Helvering v. Brooklyn City R. Co., 72 F. (2d) 274, 275 (C. C. A. 2); Sugar Creek Coal & Mining Co. v. Commissioner, 31 B. T. A. 344 (No. 72). Hence the fact that neither the petitioner nor the Viscose Company reported the sale of stock at less than its value as constituting income to the petitioner in 1922 is not material to the present issue, even though it may now be too late for the government to assess an income tax for that year.

The next step was the exchange of the 1,500 "bargain" shares and the 25 additional shares of Viscose stock for preferred and common shares of American Viscose stock. The cost base of the bargain shares, as shown above, was $606,300, and the cost base of the additional shares was $4,166.66, a total of $610,466.66. Assuming for the present that the cost base can be apportioned, according to the percentages adopted by the Commissioner, between the preferred and common shares received in exchange, the basis for the preferred shares is 37.778 percent of $610,466.66, or $230,622.09, and the basis for the common is 62.222 percent, or $379,844.57.

This brings us to the other contention, namely, that no apportionment between preferred and common stock is proper. Article 1567 of Regulation 62, so far as applicable, reads as follows:

"* * * If property is exchanged for two kinds of property and no gain or loss is recognized under articles 1564 or 1566, the cost of the original property should be apportioned, if possible, between the two kinds of property received in exchange for the purpose of determining gain or loss upon subsequent sale. If no fair apportionment is practicable, no profit on any subsequent sale of any part of the property received in exchange is realized until out of the proceeds of sale shall have been recovered the entire cost of the original property."

The validity of this regulation has been recognized by the courts. Houghton v. Com'r, 71 F. (2d) 656 (C. C. A. 2), certiorari denied 55 S. Ct. 124, 79 L. Ed. —; Curtiss v. Com'r, 57 F. (2d) 847 (C. C. A. 5); Kirkland v. Burnet, 61 App. D. C. 88, 57 F. (2d) 608. Indeed, the taxpayer does not question its validity but contends that by its very terms, since no fair apportionment of the cost was practicable, the entire cost of the old stock must be recovered from the amount realized by redemption of the new preferred. He argues that in The Viscose Co., 3 B. T. A. 444, the Board held that the assets of the corporation could not be accurately valued because they were a
139 mixed aggregate of tangible and intangible property, and therefore urges that it was impossible in 1922 to value the stock by the formula adopted by the Commissioner. The Commissioner adopted a method which this court approved in Houghton v. Commissioner, supra. Moreover, it was in exact accord with the report

made by a firm of certified public accountants employed by the taxpayer for the very purpose of determining his federal income tax in accordance with the regulations. Although there were no actual sales of either the old or the new stock, there can be no doubt that it could have been sold, if offered, for the business had been extraordinarily successful over a period of several years. The taxpayer has not proved that the market value ascribed by the Board to preferred and common stock was erroneous or that no fair apportionment between them of the cost of the old stock was practicable. We accept the Board's finding that it was practicable.

It is true that the Board did not consider the fact that five-sevenths of the 1,500 Viscose shares acquired in 1922 were subject to an option. Its apportionment was made on the assumption that each share of Viscose had a market value of $1,164.70 and was exchanged for a block of four shares of preferred and five shares of common of American Viscose, which, as a block, had a value of $1,164.70. Because of the option, each optioned share of Viscose had a value of only $100, and the block of American Viscose for which it was exchanged also had a value of only $100 because as a block it was subject to the option. We see no reason, however, why the consideration paid for the optioned block should not be apportioned between preferred and common shares constituting it, on the same basis as in the case of a block not subject to the option. Accordingly the cost base of the 6,100 shares of preferred was, as shown above, $230,622.09. As the base adopted by the Commissioner was $58,123.47, it follows that there was no deficiency in tax, but a substantial overpayment, the exact amount of which should be determined by the Board in accordance with the principles laid down in the foregoing opinion.

Order reversed, and cause remanded.

140 In United States Circuit Court of Appeals, Second Circuit

SAMUEL A. SALVAGE, PETITIONER

*vs.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

*Decree*

Filed March 25, 1935

Appeal from the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said United States Board of Tax Appeals be, and it hereby is, reversed.

It is further ordered that a Mandate issue to the said Board in accordance with this decree.

WM. PARKIN, *Clerk.*

141 [File endorsement omitted.]

142 [Clerk's certificate to foregoing transcript omitted in printing.]

143 Supreme Court of the United States

*Order extending time within which to apply for writ of certiorari*

No. 280. October term, 1935

Filed June 25, 1935

On consideration of the motion of counsel for petitioner in the above-entitled cause, and good cause therefor having been shown,

It Is Ordered that the time within which petition for writ of certiorari may be filed herein be, and the same is hereby, extended for a period of 30 days from this date.

J. C. MCREYNOLDS,
*Associate Justice of the Supreme Court of the United States.*

Dated this 25th day of June, 1935.

144 Supreme Court of the United States

No. 173. October term, 1935

*Order allowing certiorari*

Filed October 14, 1935

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

145 Supreme Court of the United States

No. 280. October term, 1935

*Order allowing certiorari*

Filed October 14, 1935

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. And it is further ordered that the duly certified copy of the transcript

of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(Endorsement on cover:) File Nos. 39,727, 39,834. U. S. Circuit Court of Appeals, Second Circuit. Term No. 173. Guy T. Helvering, Commissioner of Internal Revenue, petitioner, vs. Samuel A. Salvage. Term No. 280. Samuel A. Salvage, petitioner, vs. Guy T. Helvering, Commissioner of Internal Revenue. Petitions for writs of certiorari and exhibit thereto. Filed June 25, 1935, and July 25, 1935. Term Nos. 173 O. T. 1935, 280 O. T. 1935.

U. S. GOVERNMENT PRINTING OFFICE: 1935

FILE COPY

No. 173

In the Supreme Court of the United States

October Term, 1945

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner

v.

William A. Sawyer

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

# INDEX


| | Page |
|---|---|
| Opinions below | 1 |
| Jurisdiction | 2 |
| Question presented | 2 |
| Statutes involved | 3 |
| Statement | 3 |
| Specification of errors to be urged | 6 |
| Reasons for granting the writ | 6 |
| Appendix | 17–18 |


## CITATIONS

Cases:


| | |
|---|---|
| *Adler* v. *Commissioner*, C. C. A. 5th, decided May 22, 1935 | 13 |
| *Askin & Marine Co.* v. *Commissioner*, 66 F. (2d) 776 | 11 |
| *Bemis* v. *Pacific Coast Casualty Co.*, 125 Minn. 54 | 14 |
| *Board of Tax Appeals* v. *United States ex rel. Shults Bread Co.*, 37 F. (2d) 442, certiorari denied, 281 U. S. 731 | 14 |
| *Boone* v. *Citizens Bank & Trust Co.*, 154 Tenn. 241 | 14 |
| *Bothwell* v. *Commissioner*, C. C. A. 10th, decided Apr. 10, 1935 | 9 |
| *Commissioner* v. *Liberty Bank & Trust Co.*, 59 F. (2d) 320 | 13 |
| *Continental Products Co.* v. *Commissioner*, 66 F. (2d) 434 | 13 |
| *Crane* v. *Commissioner*, 68 F. (2d) 640 | 9 |
| *Dickerson* v. *Colgrove*, 100 U. S. 578 | 9 |
| *Feinberg* v. *Allen*, 208 N. Y. 215 | 14 |
| *Giant Furniture Co.* v. *United States*, 9 F. Supp. 585 | 13 |
| *Greengard* v. *Commissioner*, 29 F. (2d) 502 | 15 |
| *Helvering* v. *Brooklyn City R. Co.*, 72 F. (2d) 274 | 11 |
| *Hall & Farley* v. *Henderson*, 126 Ala. 449 | 14 |
| *Hanby* v. *Commissioner*, 67 F. (2d) 125 | 15 |
| *Herbert* v. *Champagne*, 144 La. 659 | 13 |
| *Intertype Corp.* v. *Pulver*, 2 F. Supp. 4, affirmed, 65 F. (2d) 419, certiorari denied, 290 U. S. 660 | 14 |
| *Kirk* v. *Hamilton*, 102 U. S. 68 | 9 |
| *Laughinghouse* v. *Insurance Co.*, 200 N. C. 434 | 14 |
| *Mabury* v. *Louisville & J. Ferry Co.*, 60 Fed. 645 | 14 |
| *Mahoning Investment Co.* v. *United States*, 3 F. Supp. 622, certiorari denied, 291 U. S. 675 | 13 |
| *Matern* v. *Commissioner*, 61 F. (2d) 663 | 13 |
| *Naumkeag Steam Cotton Co.* v. *United States*, 2 F. Supp. 126, certiorari denied, 289 U. S. 749 | 13 |
| *Nelson* v. *Chicago Mill & Lumber Corp.*, 76 F. (2d) 17 | 9 |

| | Page |
|---|---|
| *Newaygo Portland Cement Co.* v. *Helvering*, App. D. C., decided April 15, 1935 | 15 |
| *New York Life Ins. Co.* v. *Rees*, 19 F. (2d) 781 | 13–14 |
| *Oklahoma* v. *Texas*, 268 U. S. 252 | 9 |
| *Paine* v. *Strom*, 51 Idaho 532 | 14 |
| *Promis* v. *Duke*, 208 Cal. 420 | 14 |
| *Shelton* v. *Southern Ry. Co.*, 255 Fed. 182 | 14 |
| *Shutter Bar Co.* v. *Zimmerman*, 110 Md. 313 | 14 |
| *Stearns Co.* v. *United States*, 291 U. S. 54 | 9 |
| *Stone* v. *Bank of Commerce*, 174 U. S. 412 | 9 |
| *Swartz, Edward G., Inc.* v. *Commissioner*, 69 F. (2d) 633 | 9 |
| *United States* v. *S. F. Scott & Sons*, 69 F. (2d) 728 | 12 |
| *United States Fidelity & Guaranty Co.* v. *Wilson*, 41 F (2d) 319 | 13 |
| *Walker* v. *Fireman's Fund Ins. Co.*, 114 Oreg. 545 | 14 |
| Statutes: | |
| Revenue Act of 1921, c. 136, 42 Stat. 227: | |
| Sec. 213 | 15 |
| Sec. 250 | 8 |
| Revenue Act of 1926, c. 27, 44 Stat. 9: | |
| Sec. 277 (U. S. C. App., Title 26, Sec. 1057) | 8 |
| Revenue Act of 1928, c. 852, 45 Stat. 791: | |
| Sec. 112 | 17 |
| Sec. 113 | 17 |
| Miscellaneous: | |
| Bigelow on Estoppel, 5th Ed., p. 699 | 14 |
| 21 C. J. 1241 | 14 |
| I. T. 2335, VI–1 Cumulative Bulletin 18 | 3 |
| Treasury Regulations 62, Art. 1567 | 3 |

# In the Supreme Court of the United States

OCTOBER TERM, 1935

---

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, Petitioner

*v.*

SAMUEL A. SALVAGE

---

**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT**

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit entered in the above-entitled cause on March 25, 1935, reversing the decision of the Board of Tax Appeals in part.

**OPINIONS BELOW**

The opinion of the Board of Tax Appeals (R. 49–56) is unreported. The opinion of the Circuit Court of Appeals (R. 135) is reported in 76 F. (2d) 112.

JURISDICTION

The judgment of the Circuit Court of Appeals, reversing the decision of the Board of Tax Appeals in part and affirming it in part, was entered on March 25, 1935. (R. 140.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

On December 30, 1922, the taxpayer exchanged 1,500 shares of stock of the Viscose Company, acquired the same day, together with 25 other shares purchased in 1916, for 6,100 shares of preferred stock and 7,625 shares of common stock of the American Viscose Corporation pursuant to a nontaxable exchange. The preferred stock was redeemed in 1929. The question is—

Whether the taxpayer is estopped to claim that the difference between the market value of the 1,500 shares as of December 30, 1922, and their cost to him constituted taxable income to him for 1922 and hence that the fair market value of these shares and not their cost [1] is the basis to be used in meas-

[1] Either the cost or the market value of the old stock will represent the total basis for measuring gain or loss from the disposition of the aggregate shares of new common and preferred stock. The court below sustained the Government's position that the basis used would have to be apportioned between the new common and new preferred stock according to their respective market values at the time of

uring the gain from the disposition of the shares in 1929, no income from the transaction having been reported in 1922.

### STATUTES INVOLVED

The statutes involved are set forth in the Appendix, *infra,* pp. 17–18.

### STATEMENT

The following facts are taken from the stipulation of facts, the memorandum opinion of the Board of Tax Appeals, and the deposition of the taxpayer:

In 1929 the taxpayer received $671,000 from the redemption of 6,100 shares of preferred stock of the American Viscose Corporation. (R. 49, 51.) This stock had been acquired December 30, 1922, together with 7,625 shares of common stock, in exchange for stock of the Viscose Company, under the following circumstances:

In December, 1922, the taxpayer, an officer and employee of the Viscose Company, held 25 shares of common stock of that company, which he had purchased at $166.66⅔ a share. (R. 49.) At that time the Viscose Company increased its capital stock by 4,000 shares and permitted him to purchase 1,500 shares at $100 a share. (R. 83–91.)

---

the exchange and approved the method of apportionment. See Section 113 (a) (6) of the Revenue Act of 1928; Article 1567 of Regulations 62, and I. T. 2335, VI–1 Cumulative Bulletin 18.

This sale was made pursuant to a contract of December 30, 1922, in consideration of his agreement not to engage in a competing business without the consent of the company. The stock was subject to repurchase in part. (R. 28–30.)[2]

On the same date that this agreement was made with the Viscose Company (hereinafter called the old company), the American Viscose Corporation (hereinafter called the new company) was incorporated in Delaware and issued 4 shares of its preferred and 5 shares of its common stock in exchange for each share of common stock of the old company. (R. 24–25.)

The taxpayer, under a separate agreement, was given the right to exchange his 1,525 shares, which had cost him an aggregate sum of $154,166.66. (R. 51, 103, 104.)

In his 1929 return, the taxpayer reported as a gain from the redemption of the preferred stock, the difference between $671,000 and $154,166.66, the entire cost of all the shares of the old company. (R. 51.)

The Commissioner determined a deficiency of $12,005.38 by determining that 37.778 percent of the cost basis of the old stock should be apportioned to the new preferred stock and 62.222 percent of such basis to the new common stock. This apportionment was made according to the relative market values of the new preferred and new common stock at the time of the exchange. (R. 26, 27, 39,

[2] The option was never exercised. (R. 51.)

49, 51–52.) This apportionment gave a basis of $58,123.47 for the preferred stock and was used by the Commissioner in measuring the gain. (R. 26.)

Before the Board the taxpayer claimed that it was not practicable to determine the market value of the preferred and common stock as of December 30, 1922, that no apportionment of the cost basis of the old stock between the new preferred and new common stock should be made, and that the entire cost should be used as a basis. In addition, he claimed a refund of $63,750, based on the contention that the proper basis of the stock received in exchange for the 1,500 old shares was not the cost of such 1,500 shares ($100 per share), but their fair market value as of the time of their acquisition ($1,164.70 per share) on the theory that the difference represented compensation for services. (R. 4–5, 52–53.)

The Board determined that the difference was not compensation for services and that neither the taxpayer nor the old company had so treated it for tax purposes. (R. 54–55.) It held that the basis was the cost of the old stock and that the basis was properly apportioned by the Commissioner. (R. 55–56.)

The court below held that the difference between the cost and market value of the old stock was not compensation for services in 1922, but that it was income realized at that time from a promise not to engage in a competing business and that the taxpayer was not estopped to present this claim. It,

therefore, held that the basis of 1,500 shares was market value and not cost, but that only two-sevenths of those shares had a market value of $1,164.70 and the remaining five-sevenths a market value of $100 a share, due to the option for repurchase by the corporation, so that the aggregate market value was $606,300.

The court further held that the basis of the old shares ($4,166.66 for the 25 shares and $606,300 for the 1,500 shares) could be apportioned according to the method used by the Commissioner, the use of which would apportion $230,662.09 to the preferred stock. Since this was in excess of the basis originally reported by the taxpayer, the court held that there was no deficiency and directed the Board to determine the amount of refund due.

## SPECIFICATION OF ERROR TO BE URGED

The Commissioner submits that the Circuit Court of Appeals erred:

In failing to hold that the taxpayer was estopped to claim that the basis for measuring the gain from the redemption of his new stock in 1929 was the fair market value of the old stock when acquired in 1922, by his failure to report the difference between the cost and fair market value as income for 1922.

## REASONS FOR GRANTING THE WRIT

The court below held that the difference between the market value of the stock of the old company and its cost to the taxpayer under the contract of

December 30, 1922, constituted taxable income to the taxpayer arising from an agreement not to engage in a competing business. On that theory it held that the basis of the old stock to be apportioned between the two kinds of new stock received in the non-taxable exchange of December 30, 1922,[3] in measuring the gain from the new preferred stock, was not the cost of the old stock, but its fair market value at the time of the exchange.

The court below thus decided the case on a theory not considered by the Board or suggested by the taxpayer, and rejected the contention of the Government that the taxpayer was estopped to claim that he had realized income in 1922 equal to the difference between the market value and the cost of the old stock and that the market value of the old stock was the basis to be used in measuring the gain from the disposition of the new.[4]

The taxpayer filed an income-tax return for 1922 in which he failed to report any income from this purchase of the stock at less than its market value or to disclose the transaction (R. 74, 75–6, 83). The assumption of the court below that the taxpayer might have disclosed the transaction in his return for 1922 even though he had not reported any income from it is clearly contrary to

[3] The total shares of new common and new preferred stock have the same basis as the old stock, since the exchange was a nontaxable exchange. Section 113 (a) (6) of the Revenue Act of 1928.

[4] This contention was made in the reargument ordered by the court on its new theory.

the record. The taxpayer admitted in his deposition that he had not reported any income from it, stated that he had not done so because he did not see how he could arrive at it, and admitted that he had not put anything in his return for 1922 or made any statement to the effect that he had received compensation the amount of which could not be liquidated or estimated (R. 75–76). He also admitted that he reported nothing but cash received in any year (R. 78), and that when he filed his 1922 return he did not consider that he had received any property of value which was not included (R. 83). The Commissioner relied upon the taxpayer's sworn return as a disclosure of his correct taxable income for the year 1922 and the time for assessing an additional tax for that year expired four years from the date of filing the return, which was required to be filed on or before March 15, 1923. See Section 250 (d) of Revenue Act of 1921 and Section 277 (a) of Revenue Act of 1926.

The case is one in which the taxpayer is claiming now that income was derived from the receipt of the stock in 1922 and a new basis established for measuring gain from the disposition of the stock in 1929, after he had previously taken the contrary position and induced the Government to rely upon it to the Government's detriment. There was thus a failure to disclose a transaction which the taxpayer was required to disclose in its sworn return, a reliance upon the taxpayer's act by the Govern-

ment, and a subsequent reversal of position by the taxpayer to the Government's detriment. The existence of these elements is all that is required to establish equitable estoppel or estoppel *in pais*. *Stone* v. *Bank of Commerce*, 174 U. S. 412; *Kirk* v. *Hamilton*, 102 U. S. 68; *Dickerson* v. *Colgrove*, 100 U. S. 578; *Oklahoma* v. *Texas*, 268 U. S. 252; *Nelson* v. *Chicago Mill & Lumber Corp.*, 76 F. (2d) 17 (C. C. A. 8th); *Stearns Co.* v. *United States*, 291 U. S. 54.

In holding that there was no estoppel in this case, the decision of the court below is directly opposed to that of the Circuit Court of Appeals for the First Circuit in *Crane* v. *Commissioner*, 68 F. (2d) 640, the decision of the Circuit Court of Appeals for the Tenth Circuit in *Bothwell* v. *Commissioner*, decided April 10, 1935, not officially reported but found in 1935 C. C. H., Vol. 3, par. 9302, and the decision of the Circuit Court of Appeals for the Fifth Circuit in *Edward G. Swartz, Inc.* v. *Commissioner*, 69 F. (2d) 633.

In the *Crane* case, the taxpayer claimed that in computing the gain from the sale of certain real estate in 1927, there should be added to the March 1, 1913, value the value of improvements made by the lessee, even though the value of those improvements had not been reported as income for earlier years, against which the statute of limitations had run. The court applied the doctrine of estoppel.

In *Bothwell* v. *Commissioner, supra,* the taxpayer, an employee of a corporation, acquired an option to purchase certain shares of its stock and exercised it in 1927, when the market value was in excess of the option price. He sold the stock in 1928 and in his amended petition before the Board, which was filed after the statute of limitations had run against 1927, claimed that the basis for measuring the gain was the market value of the stock in 1927 and not its cost. The court rejected that contention, holding that if the difference between the option price and the market value of the stock were income for 1927, the taxpayer was required to report it, that his failure to report it was in effect a declaration that no such income had been received, and that by his wrongful acts and omissions he was precluded from asserting otherwise.

In the *Swartz* case, *supra,* a timber owner, Swartz, had assigned a profit-sharing timber contract with one corporation to another corporation, of which he was sole stockholder. The taxpayer corporation reported the income each year for a number of years as assignee and had based depletion on cost of timber or its fair market value as of March 1, 1913, but in 1926, for the purpose of eliminating all tax liability for that year, adopted the theory that Swartz was still taxable upon the income and that in any event there was a taxable exchange of timber for a contract in 1919 from which a profit was realized, though not reported, and that the value of the contract became the basis

for depletion. The court held that estoppel barred both contentions.

We believe that the three cases just cited are indistinguishable on the facts from the present case and hence that there is a direct conflict.

The court below cited its own decision in *Helvering* v. *Brooklyn City R. Co.*, 72 F. (2d) 274, as authority for its position. The question in that case was whether the taxpayer was estopped to contend that a return for the calendar year 1921 should have been a return for a fiscal year. The court there held there was no estoppel. But in that case a cursory examination of the taxpayer's books would have disclosed the fact that they were kept on a fiscal year basis and the statute required that the returns must be made on the same basis as the books. It was not shown that the tax for earlier years would have been greater if the returns had been properly filed, and in the only year in which it might have been said that the Government was injured, it was not shown whether the question was raised so late as to prevent a correction.

The same court in the earlier case of *Askin & Marine Co.* v. *Commissioner*, 66 F. (2d) 776, held that where a taxpayer had charged off certain debts as worthless in one year and subsequently collected them, he would not be heard to say that they were not worthless in that year for the purpose of eliminating from his return the income represented by the collections in the later year.

In the case of *United States* v. *S. F. Scott & Sons,* 69 F. (2d) 728 (C. C. A. 1st), the same court that decided the *Crane* case determined that there was no estoppel, for the reason that the error originated in the misconstruction of the law by the Commissioner and if there had been any misleading, the Government rather than the taxpayer had been guilty of it.

In addition to the *Crane, Bothwell;* and *Swartz* cases, which are directly opposed to the decision in this case, there is a long list of cases in which the courts have applied the doctrine of estoppel to comparable situations.

In *Stearns Co.* v. *United States,* 291 U. S. 54, this Court held that where a taxpayer, in filing a claim for overpayment of income taxes for several years, asked that the amount overpaid be credited against an unpaid tax and the Commissioner after considering the claim so does, the taxpayer is estopped from claiming the amount is still due him upon the ground that the collection of the unpaid tax had in the meantime been barred by limitation. The instant case presents the question whether a taxpayer who has treated a contract in one way for tax purposes may thereafter treat it in another way, with the result that, if his theory be accepted, certain taxable income will escape tax altogether. This type of question frequently arises; it is therefore desirable to have the Court determine whether the principle applied in the *Stearns* case applies likewise to the situation herein.

Other cases applying the principle of estoppel where the Government would be injured through the taxpayer's change of position are *Giant Furniture Co.* v. *United States,* 9 F. Supp. 585 (C. Cls.); *Adler* v. *Commissioner,* decided by the Circuit Court of Appeals for the Fifth Circuit on May 22, 1935, not yet officially reported but found in 1935 C. C. H., Vol. 3, par. 9397; *Naumkeag Steam Cotton Co.* v. *United States,* 2 F. Supp. 126 (C. Cls.), certiorari denied, 289 U. S. 749; *Commissioner* v. *Liberty Bank & Trust Co.,* 59 F. (2d) 320 (C. C. A. 6th); *Continental Products Co.* v. *Commissioner,* 66 F. (2d) 434 (C. C. A. 1st); *Mahoning Investment Co.* v. *United States,* 3 F. Supp. 622 (C. Cls.), certiorari denied, 291 U. S. 675; *Matern* v. *Commissioner,* 61 F. (2d) 663 (C. C. A. 9th).

Finally, we call the attention of the Court to the fact that the failure of the court below to apply the doctrine of estoppel [5] will not only eliminate the

---

[5] In his petition the taxpayer made no contention that any part of the difference between the market value of the 1,500 shares as of December 30, 1922, and their cost to him, constituted a payment for his agreement not to compete and hence constituted income based thereon in 1922. The answer of the respondent, therefore, did not contain a plea of estoppel. The issue was first raised by the Circuit Court of Appeals when it asked for a reargument on the point. No question was raised either by the taxpayer or by the court below as to the failure of the pleadings to present the issue or the plea of estoppel. Even if it had been, however, we believe the failure to plead estoppel would be excused because the issue was not raised in the petition, and hence there was no reason or opportunity to plead estoppel. *United States Fidelity & Guaranty Co.* v. *Wilson,* 41 F. (2d) 319 (C. C. A. 8th); *Herbert* v. *Champagne,* 144 La. 659; *New*

deficiency proposed by the Commissioner for 1929, but will result in the allowance of a refund. We believe that that fact furnishes a circumstance

---

*York Life Ins. Co.* v. *Rees*, 19 F. (2d) 781 (C. C. A. 8th); *Paine* v. *Strom*, 51 Idaho 532. Moreover, at common law it was not necessary to plead estoppel *in pais*. *Feinberg* v. *Allen*, 208 N. Y. 215; *Boone* v. *Citizens Bank & Trust Co.*, 154 Tenn. 241; *Shelton* v. *Southern Ry. Co.*, 255 Fed. 182 (E. Tenn.); 21 C. J. 1241; Bigelow on Estoppel, 5th Ed., p. 699. That is still the law in some jurisdictions (see *Shutter Bar Co.* v. *Zimmerman*, 110 Md. 313; *Feinberg* v. *Allen*, *supra; Intertype Corp.* v. *Pulver*, 2 F. Supp. 4 (S. D. Fla.), affirmed, 65 F. (2d) 419 (C. C. A. 5th), certiorari denied, 290 U. S. 660; *Bemis* v. *Pacific Coast Casualty Co.*, 125 Minn. 54), while in others it must be pleaded if there is opportunity. *Laughinghouse* v. *Insurance Co.*, 200 N. C. 434; *Hall & Farley* v. *Henderson*, 126 Ala. 449; *Mabury* v. *Louisville & J. Ferry Co.*, 60 Fed. 645 (C. C. A. 7th); *Promis* v. *Duke*, 208 Cal. 420; *Walker* v. *Fireman's Fund Ins. Co.*, 114 Ore. 545. Each State has its own rule, influenced to a considerable extent by its statutes concerning pleading. Section 907 (a) of the Revenue Act of 1924 as amended by Section 1000 of the Revenue Act of 1926 and by Section 601 of the Revenue Act of 1928 provides that the proceedings of the Board and its divisions shall be conducted in accordance with such rules of practice and procedure (other than rules of evidence) as the Board may prescribe and in accordance with the rules of evidence applicable in courts of equity in the District of Columbia. The Board rules do not contain any reference to estoppel. The only rule at all pertinent is Rule 14, which requires the Commissioner to file an answer which shall contain "a specific admission or denial of each material allegation of fact contained in the petition and a statement of any facts upon which the Commission relies for defense or for affirmative relief or to sustain any issue raised in the petition in respect of which issue the burden of proof is, by statute, placed on the Commissioner." In *Board of Tax Appeals* v. *United States ex rel. Shults Bread Co.* (App. D. C.), 37 F.

which should have been but was not considered by the court below, for equitable principles are given particular application in the case of a repayment. See *Newaygo Portland Cement Co.* v. *Helvering,* decided by the Court of Appeals for the District of Columbia on April 15, 1935, not yet officially reported but found in 1935 C. C. H., Vol. 3, par. 9320.

CONCLUSION

The decision is in conflict with decisions of other Circuit Courts of Appeals. The question of the application of estoppel is involved in a number of cases now pending before the Bureau of Internal Revenue and the courts, and will arise in subsequent cases. We respectfully submit that this petition should be granted.

STANLEY REED,
*Solicitor General.*

JUNE 1935.

---

(2d) 442, certiorari denied, 281 U. S. 731, the Court of Appeals for the District of Columbia held that mandamus should not issue to compel the Board to enter judgment for the taxpayer by default, when the Commissioner had not filed his answer in time. See also *Greengard* v. *Commissioner*, 29 F. (2d) 502 (C. C. A. 7th). In *Hanby* v. *Commissioner*, 67 F. (2d) 125 (C. C. A. 4th), it was held that a question of fraud was properly put in issue although not affirmatively alleged in the Commissioner's answer where it was obvious to petitioner that fraudulent conduct on his part formed the basis of the Commissioner's determination. These decisions indicate that the Board, an administrative body, is not bound by strict rules of pleading and that the Circuit Court of Appeals had authority to consider the estoppel issue. Both the Board and the Circuit Court of Appeals considered the question of estoppel in the *Crane* case, though the issue was not raised in the pleadings.

# APPENDIX

REVENUE ACT OF 1928, C. 852, 45 STAT. 791

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

* * * * *

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

REVENUE ACT OF 1921, C. 136, 42 STAT. 227

SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain

or profit, or gains or profits and income derived from any source whatever. The amount of all such items (except as provided in subdivision (e) of section 201) shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; * * *

U. S. GOVERNMENT PRINTING OFFICE: 1939

FILE COPY.

FILED
JUL 25 1935
CHARLES ELMORE CROPLEY
CLERK

IN THE

# Supreme Court of the United States

**OCTOBER TERM, 1935.**

**No. 280.**

SAMUEL A. SALVAGE,
*Petitioner,*

*against*

GUY T. HELVERING, Commissioner of Internal Revenue,
*Respondent.*

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

JOHN G. JACKSON,
WILLIAM H. WHITE, JR.,
GEORGE B. BROOKS,
*Counsel for Petitioner.*

# INDEX.


| | PAGE |
|---|---|
| Opinions below | 1 |
| Jurisdiction | 2 |
| Question presented | 2 |
| Statutes involved | 2-3 |
| Statement | 3 |
| Specification of errors to be urged | 4 |
| Reasons for granting the writ | 4 |
| Appendix | 7 |


## CITATIONS.

*Cases:*


| | |
|---|---|
| Avery *v.* Commissioner, 22 F. (2) 6 | 6 |
| Griffiths *v.* Commissioner, 70 F. (2) 946 | 6 |
| Heiner *v.* Crosby, 24 F. (2) 191 | 5 |
| Helvering *v.* General Utilities and Operating Co., C. C. A. 4th, decided Jan. 8, 1935 | 6 |
| Tricou *v.* Commissioner, 68 F. (2) 280 | 6 |
| Wilson *v.* Bowers, 57 F. (2) 682 | 5 |


*Statutes:*


| | |
|---|---|
| Act of Feb. 26, 1926, c. 27, Sec. 1003, 44 Stat. 110 | 3 |

IN THE

# SUPREME COURT OF THE UNITED STATES,

OCTOBER TERM, 1935.

No.

SAMUEL A. SALVAGE,
*Petitioner,*
*against*
GUY T. HELVERING, Commissioner of Internal Revenue,
*Respondent.*

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

The above named petitioner prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit, entered in the above entitled cause on March 25, 1935, reversing the decision of the Board of Tax Appeals in part. The Commissioner has likewise petitioned this Court for a like writ (No. 173 October Term) and, if said petition is granted, the entire cause will not be before the Court for consideration unless this writ is granted (*Lloyd Sabaudo Societa* v. *Elting*, 287 U. S. 329).

### Opinions Below.

The opinion of the Board of Tax Appeals (R. 49-56) is unreported. The opinion of the Circuit Court of Appeals (R. 135) is reported in 76 F. 2nd, 112.

## Jurisdiction.

The judgment of the Circuit Court of Appeals, reversing the decision of the Board of Tax Appeals in part and affirming it in part, was entered on March 25, 1935 (R. 140). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

## Questions Presented.

On December 30, 1922, petitioner acquired 1,500 shares of the stock of The Viscose Company, paying $100. a share therefor, under a contract which gave the seller the right to repurchase five-sevenths of said stock at $100. a share in equal installments in each of the succeeding five years. On the same day said stock was exchanged for 6,000 shares of the preferred stock and 7,500 shares of the common stock of American Viscose Corporation. The repurchase option was transferred to the new stock but never exercised. The preferred stock was redeemed in 1929. The questions are:

1. Whether the proper cost base of said preferred stock so redeemed should be arrived at by an apportionment of (1) the true value of or (2) the cash paid for The Viscose Company stock.

2. Whether the Circuit Court of Appeals exceeded its jurisdiction in making the finding of such value.

## Statutes Involved.

The statutes involved are set forth in the appendix to the petition of the Commissioner in this cause, and in addition, there is involved Section 1003, Act of February 26, 1926, Chap. 27, 44 Stat. 110, as follows:

> "Sec. 1226. *Courts vested with jurisdiction; review; powers of reviewing court.* (a) The Circuit Court of Appeals and the Court of Appeals of the District of Columbia shall have exclusive jurisdic-

tion to review the decisions of the board (except as provided in section 346 of Title 28); and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 347 of Title 28.

(b) Upon such review, such courts shall have power to affirm or, if the decision of the board is not in accordance with law, to modify or reverse the decision of the board, with or without remanding the case for a rehearing, as justice may require. (Feb. 26, 1926, c. 27, Sec. 1003, 44 Stat. 110.)"

**Statement.**

The following facts are taken from the stipulation of facts, and the deposition of the taxpayer:

On December 30, 1922, the petitioner, an officer and employee of The Viscose Company, purchased from that company 1,500 shares of its stock, paying $100. a share therefor (R. 25). The contract of purchase provided in effect that he would not during his life engage in any competing activity, and gave to the company the right to repurchase one-seventh of said stock during each of the succeeding five years (R. 29). On the same day this stock was exchanged, on a non-taxable exchange, for 6,000 shares of preferred stock and 7,500 shares of the common stock of American Viscose Corporation, subject to the same option to repurchase. The option to repurchase was never exercised (R., p. 69). In 1929 the preferred stock was redeemed, together with a few other shares held by petitioner, and petitioner received $660,000. for said 6,000 shares of preferred stock.

The Commissioner found the actual value of the original stock on December 30, 1922, to be $1,164.70 per share. He allocated the actual value to the new common and preferred shares in the usual method, and this determined the portion of the cash paid ($100. per share) attributable to each class of new stock, namely $9.4445 for each share of preferred and $12.4444 for each share of common. As a result of this

apportionment, he found a deficiency of $12,005.38. Before the Board of Tax Appeals petitioner contended, among other things, that the difference between $100. per share paid by him for the old stock and the value of $1,164.70 per share fixed by the Commissioner, represented additional compensation to him under his contract, and was not subject to tax for the year 1929.

The Board upheld the Commissioner's contention that such difference in value did not represent such compensation. The Circuit Court of Appeals sustained the petitioner to the extent of holding that such difference in value was received by petitioner in respect to the two-sevenths of the stock which became his absolutely in December of 1922, but held that as to the five-sevenths of the stock which was subject to the option of repurchase at $100. a share, the fair market value was the option price, and not the price fixed by the Commissioner.

## Specifications of Error to Be Urged.

The petitioner submits that the Circuit Court of Appeals erred:

1. In holding that the cost base of the preferred stock of American Viscose Corporation redeemed in 1929 was to be arrived at by taking as the fair market value of The Viscose Company stock the sum of $100. per share insofar as the five-sevenths of said stock which was subject to the option to repurchase was concerned.

2. In making a finding as to the value of said optioned stock.

## Reasons for Granting the Writ.

(a) As to Specification 1.

The fundamental question before the Court on the claim for refund was the question of what figure should be used as representing the cost to the taxpayer of the preferred stock redeemed in 1929. Upon this figure the amount of

his gain was necessarily based. It would make no difference whether the figure was arrived at for the year 1922, or in part, for the several years succeeding, as the option expired. The Commissioner used the value of the old stock as of December 30, 1922, to wit, $1164.70 per share, and conceded that the difference of $1,064.70 would constitute taxable income, if it was held to be compensation for services (R. 137). The Circuit Court, however, despite this concession, limited the value of five-sevenths of said stock to $100 per share, the option price. It is submitted that the Court overlooked the fundamental question. Even assuming that the value to the taxpayer of this stock on December 30, 1922 was only $100 per share by reason of the existence of the option, nevertheless, as the option expired as to the several parts of the stock, and the stock came into the possession of the taxpayer without restriction, necessarily a new cost base was established. The record shows (R., p. 73) the continuous and tremendous growth of the company's business during the years in which the option existed. Clearly the value of the stock was intrinsically at least as great as the value on December 30, 1922.

The only reported case which we have found is *Wilson* v. *Bowers*, 57 F. (2) 682, the case upon which the Circuit Court based its decision. This was an inheritance tax case, and so far as we can find, the question has not been passed on in connection with income tax. In that case there was no relationship of employer and employee, and no contract restricting the employee's activities. The record shows that it was not intended that the option be exercised if taxpayer continued his services (R. fol. 208). Fair market price or value of corporate stock for income tax purposes is a fact question depending on circumstances. *Heiner* v. *Crosby*, 24 F. (2) 191. The possibilities of tax avoidance or evasion existing if the rule of *Wilson* v. *Bowers* is adopted, are obvious.

It is submitted that an important question not heretofore determined by the Court exists and the writ should be granted.

(b) As to Specification 2.

The jurisdiction of the Circuit Court is limited to a review of questions of law. *Avery* v. *Commissioner,* 22 F. (2) 6; *Tricou* v. *Commissioner,* 68 F. (2), 280, 286. While in certain cases the Circuit Court has considered questions not raised below, such questions are only considered when all the facts relevant thereto are before the Court. *Helvering* v. *General Utilities and Operating Co.,* C. C. A. 4, Jan. 8, 1935; *Griffiths* v. *Commissioner,* 70 F. (2) 946. The only fact apparently considered by the Court in this instance was the contract itself. The circumstances relating to the value of the stock on the several dates of the expiration of the option were not in evidence, except as above indicated. If the theory of the Court were sound, namely, that the stock only had a market value of $100 per share on December 30, 1922, then necessarily there must have been a change in this value as of the several subsequent dates. The Court should either have adopted the value taken by the Commissioner, which was in evidence before it, or remanded the matter for further testimony as to value upon the subsequent dates.

## CONCLUSION.

**For the reasons above stated, we respectfully submit that this petition should be granted.**

JOHN G. JACKSON,
WILLIAM H. WHITE, JR.,
GEORGE B. BROOKS,
*Counsel for Petitioner.*

July, 1935.

# APPENDIX.

## REVENUE ACT OF 1928, C. 852, 45 STAT. 791.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

* * * * * * *

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * * * *

## REVENUE ACT OF 1921, C. 136, 42 STAT. 227.

SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items (except as provided in subdivision (e) of section 201) shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; * * *

FILED
NOV 13 1935
CHARLES ELMORE CROPLEY

FILE COPY

No. 173

# In the Supreme Court of the United States

OCTOBER TERM, 1935

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

SAMUEL A. SALVAGE

*ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT*

## BRIEF FOR THE PETITIONER

# INDEX


| | Page |
|---|---|
| Opinions below | 1 |
| Jurisdiction | 1 |
| Question presented | 2 |
| Statutes and other authorities involved | 2 |
| Statement | 2 |
| Specification of error to be urged | 8 |
| Summary of argument | 8 |
| Argument | 9 |
| Conclusion | 22 |
| Appendix | 23 |


## CITATIONS


| Cases: | |
|---|---|
| *Adler* v. *Commissioner*, 77 F. (2d) 733 | 17 |
| *Askin & Marine Co.* v. *Commissioner*, 66 F. (2d) 776 | 16, 18 |
| *Bemis* v. *Pacific Coast Casualty Co.*, 125 Minn. 54 | 20 |
| *Board of Tax Appeals* v. *United States ex rel. Shults Bread Co.*, 37 F. (2d) 442, certiorari denied, 281 U. S. 731 | 20 |
| *Boone* v. *Citizens Bank & Trust Co.*, 154 Tenn. 241 | 19 |
| *Bothwell* v. *Commissioner*, 77 F. (2d) 35 | 13 |
| *Bull* v. *United States*, 295 U. S. 247 | 18, 19 |
| *Commissioner* v. *Liberty Bank & Trust Co.*, 59 F. (2d) 320 | 16 |
| *Commissioner* v. *Moore*, 48 F. (2d) 526 | 16 |
| *Commissioner* v. *Van Vorst*, 59 F. (2d) 677 | 11 |
| *Continental Products Co.* v. *Commissioner*, 66 F. (2d) 434 | 17 |
| *Crane* v. *Commissioner*, 68 F. (2d) 640 | 14, 21 |
| *Dickerson* v. *Colgrove*, 100 U. S. 578 | 12 |
| *Feinberg* v. *Allen*, 208 N. Y. 215 | 19 |
| *Giant Furniture Co.* v. *United States*, 9 F. Supp. 585 | 16 |
| *Gilcrest Co.* v. *Des Moines*, 157 Iowa 525 | 20 |
| *Greengard* v. *Commissioner*, 29 F. (2d) 502 | 20 |
| *Haag* v. *Commissioner*, 59 F. (2d) 514 | 16 |
| *Hall & Farley* v. *Henderson*, 126 Ala. 449 | 20 |
| *Hanby* v. *Commissioner*, 67 F. (2d) 125 | 20 |
| *Hartwell Mills* v. *Rose*, 61 F. (2d) 441 | 17 |
| *Helvering* v. *Brooklyn City R. Co.*, 72 F. (2d) 274 | 17 |
| *Helvering* v. *General Utilities & Operating Co.*, 74 F. (2d) 972 | 21 |




29469—35——1

Cases—Continued.


| | Page |
|---|---|
| *Intertype Corp.* v. *Pulver*, 2 F. Supp. 4, affirmed, 65 F. (2d) 419, certiorari denied, 290 U. S. 660 | 20 |
| *Kirk* v. *Hamilton*, 102 U. S. 68 | 12 |
| *Larkin* v. *United States*, 78 F. (2d) 951 | 11, 14 |
| *Laughinghouse* v. *Insurance Co.*, 200 N. C. 434 | 20 |
| *Mabury* v. *Louisville & J. Ferry Co.*, 60 Fed. 645 | 20 |
| *Mahoning Investment Co.* v. *United States*, 3 F. Supp. 622, certiorari denied, 291 U. S. 675 | 17 |
| *Matern* v. *Commissioner*, 61 F. (2d) 663 | 16 |
| *Moran* v. *Commissioner*, 67 F. (2d) 601 | 17 |
| *Naumkeag Steam Cotton Co.* v. *United States*, 2 F. Supp. 126, certiorari denied, 289 U. S. 749 | 17 |
| *North American Oil* v. *Burnet*, 286 U. S. 417 | 16 |
| *Oklahoma* v. *Texas*, 268 U. S. 252 | 12 |
| *Promis* v. *Duke*, 208 Cal. 420 | 20 |
| *Putnam Nat. Bank* v. *Commissioner*, 50 F. (2d) 158 | 17 |
| *Robinson* v. *Commissioner*, 59 F. (2d) 1008 | 11 |
| *Shelton* v. *Southern Ry. Co.*, 255 Fed. 182 | 19 |
| *Shutter Bar Co.* v. *Zimmerman*, 110 Md. 313 | 19 |
| *Stearns Co.* v. *United States*, 291 U. S. 54 | 12 |
| *Stone* v. *Bank of Commerce*, 174 U. S. 412 | 12 |
| *Swartz, Edward G., Inc.* v. *Commissioner*, 69 F. (2d) 633 | 16 |
| *Taplin* v. *Commissioner*, 41 F. (2d) 454 | 11 |
| *United States* v. *S. F. Scott & Sons*, 69 F. (2d) 728 | 17 |
| *Walker* v. *Fireman's Fund Ins. Co.*, 114 Ore. 545 | 20 |
| *Wheelock* v. *Commissioner*, 77 F. (2d) 474 | 16 |
| Statutes: | |
| Revenue Act of 1921, c. 136, 42 Stat. 227, 237, 250: | |
| Sec. 213 | 10, 16, 23 |
| Sec. 223 | 10, 23 |
| Revenue Act of 1928, c. 852, 45 Stat. 791, 816, 818: | |
| Sec. 112 | 24 |
| Sec. 113 | 25 |
| Miscellaneous: | |
| Bigelow on Estoppel, 5th Ed., p. 699 | 19 |
| T. D. 3435, II-1 Cumulative Bulletin 50 | 10, 26 |
| Treasury Regulations 62, Art. 51 | 16 |

# In the Supreme Court of the United States

OCTOBER TERM, 1935

No. 173

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

*v.*

SAMUEL A. SALVAGE

*ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT*

## BRIEF FOR THE PETITIONER

### OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 28–32) is unreported. The opinion of the Circuit Court of Appeals (R. 74–78) is reported in 76 F. (2d) 112.

### JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 25, 1935. (R. 78.) The petition for a writ of certiorari was filed June 25, 1935, and granted October 14, 1935. The jurisdiction of this Court is invoked under Section 240(a) of the

Judicial Code, as amended by the Act of February 13, 1925.

## QUESTION PRESENTED

Where an employee purchases stock from his employer at an amount substantially less than its fair market value and fails to report the difference as income in his return for the year in which the purchase was made, is he, in computing the profit from the redemption of the stock in a later year, estopped to claim that the basis for measuring the gain from the redemption is not the actual cost to him but the fair market value of the stock as of the date of its receipt?

## STATUTES AND OTHER AUTHORITIES INVOLVED

The applicable statutes and other authorities involved will be found in the Appendix, *infra*, pp. 23–26.

## STATEMENT

The following facts are taken from the stipulation of facts, the memorandum opinion of the Board of Tax Appeals, and the deposition of the taxpayer:

In December, 1922, the respondent, an officer and employee of the Viscose Company, owned 25 shares of stock of that Company which he had purchased in 1916 at a cost of $166.66⅔ a share. (R. 28.) On December 15, 1922, the stockholders and directors of the Viscose Company authorized it to increase its capital stock by 4,000 shares and the issuance of 1,500 of these shares to respondent at par ($100). (R. 46–50.)

On December 30, 1922, an agreement was made between the respondent and the Viscose Company which recited that the Company had sold 1,500 shares of its stock to the respondent at par, and provided, in part, as follows (R. 14, 15):

> 1. That Salvage does hereby agree to and with the Company that the said Company shall have the right to repurchase from him or his nominees, and he does hereby undertake, on behalf of himself, his heirs, executors, administrators and assigns, to procure for and deliver to the said Company for repurchase at par, the following proportions of the said 1,500 shares:
>
> At any time during the year 1923, five-sevenths;
>
> At any time during the year 1924, four-sevenths;
>
> At any time during the year 1925, three-sevenths;
>
> At any time during the year 1926, two-sevenths;
>
> At any time during the year 1927, one-seventh of the said 1,500 shares.
>
> 2. Salvage does further hereby agree to and with the Company that he will not at any time during his life in any part of the United States of America, except the States of Utah, Nevada, and New Mexico, Canada, the United Kingdom of Great Britain, or the Free State of Ireland, directly or indirectly, alone or in partnership, or as a Director or other Officer of a corporate body or as an Agent or otherwise howsoever, carry on or

> be engaged in any trade, business, or occupation for the manufacture or production of artificial silk, rayon, or Viscose, or of any material goods, or articles from Viscose in any form, nor enter into the service of or, directly or indirectly, assist or act for any person, firm, or corporation, in such trade or business or manufacturing or contemplating the manufacture of artificial silk or rayon, without the express written consent of the said Company. .

The option above referred to was never exercised. (R. 29.)

On the same date that this agreement was made with the Viscose Company (hereinafter referred to as the old Company), the American Viscose Corporation (hereinafter called the new Company) was incorporated in Delaware and issued four shares of its preferred and five shares of its common stock in exchange for each share of stock of the old Company. (R. 12.)

On the same day (December 30, 1922), the respondent exchanged his 1,525 shares of stock of the old Company which had cost him $154,166.66 [1] for 6,100 shares of preferred stock and 7,625 shares of common stock of the new Company. The preferred shares were callable at $110 per share and were redeemed at that figure in 1929, the respondent receiving $671,000 upon such redemption. (R. 29.)

---

[1] 25 shares purchased in 1916 for $4,166.66 and 1,500 shares purchased December 30, 1922, for $150,000, total $154,166.66.

In filing his income-tax return for 1929 the respondent reported as capital net gain from the redemption of the preferred stock the difference between $671,000, the amount received for it, and $154,166.66, the entire cost of his 1,525 shares of old Company stock exchanged for preferred and common stock of the new Company. (R. 29.)

The Commissioner determined a deficiency of $12,005.38 by resolving that 37.778 percent of the cost of the old stock should be apportioned to the new preferred stock, and 62.222 percent of such cost to the new common stock. This apportionment was arrived at by finding that the preferred and common stock of the new Company had values of $110 and $144.94 per share, respectively, as of the date of exchange. (R. 13, 20, 29.) Such apportionment was in accord with the allocation made by a firm of certified public accountants employed by the respondent for the purpose of arriving at the capital net gain. (R. 17, 22.) In this manner the Commissioner determined that the total cost to the respondent of 6,100 shares of the preferred stock of the new Company was $58,123.47 (37.778 percent of $154,166.66), and that the difference between that amount and $671,000, or $612,876.52, was the correct amount of capital net gain. (R. 29.)

Before the Board the respondent claimed that it was not practicable to determine the fair market value of the preferred and common stock as of December 30, 1922, that no apportionment of the

cost of the old stock between the new preferred and new common should be made, and that the entire cost of the old stock should be used as a basis for determining the capital net gain resulting from redemption of the preferred shares in 1929. In addition, he claimed a refund of $63,750 on the ground that the proper basis for valuation of the stock received in exchange for the 1,500 old shares was not the cost of such 1,500 shares ($100 per share), but their fair market value as of the date of their acquisition ($1,164.70 per share), his theory being that the difference between the cost and fair market value represented compensation for his services as president of the old and new Companies, and consideration for his covenant not to engage in a competing business. (R. 2–3, 29–30.)

The Board found that such difference was not compensation for services and that neither the respondent nor the company had so treated it for tax purposes. It held that the basis for determining the capital net gain resulting from redemption of the preferred shares in 1929 was the cost of the old stock and not its fair market value, and that the cost was properly apportioned by the Commissioner between the preferred and the common shares. (R. 29, 31–32.)

The court below agreed in holding that the difference between the cost and market value of the old stock was not compensation for services in 1922; but it held that such difference was income realized

in 1922 as consideration for respondent's promise not to engage in a competing business, and that respondent was not estopped to claim that the basis for determining the capital net gain realized from redemption of the preferred shares in 1929 was the fair market value of the old stock when acquired in 1922, notwithstanding the difference between the cost and the fair market value was not reported by him as income for that year or any other year. It therefore held that the basis for determining the capital net gain realized from redemption of the preferred shares in 1929 was the fair market value of the old stock when acquired in 1922 and not cost; but that only two-sevenths of the 1,500 shares then had a market value of $1,164.70 per share, or a total value of $499,157.14, the remaining five-sevenths having then a market value of $100 per share, or a total value of $107,142.86, by reason of the option of the corporation to repurchase, so that the aggregate market value of the 1,500 shares when acquired in 1922 was $606,300, though the respondent paid for them only $150,000, the difference being the consideration for his agreement not to compete. (R. 76.)

The court further held that the cost base of the old shares ($4,166.66 for the 25 shares and $606,300 for the 1,500 shares) should be apportioned according to the method used by the Commissioner. This gives a cost base of $230,662.09 (37.778 percent) for the preferred stock and of $379,844.57 (62.222 per-

cent) for the common. Since such cost base for the preferred stock was in excess of the cost base originally reported by the respondent, the court held that there was no deficiency and directed the Board to determine the amount of the refund due. (R. 77, 78.)

### SPECIFICATION OF ERROR TO BE URGED

The Circuit Court of Appeals erred:

In failing to hold that the respondent was estopped to claim that the basis for measuring the gain from the redemption of his new stock in 1929 was the fair market value of the old stock when acquired in 1922, by his failure to report the difference between the cost and fair market value as income for 1922.

### SUMMARY OF ARGUMENT

A litigant may not found a claim on his own omissions or wrongful acts. The respondent, having purchased from his employer on December 30, 1922, for $100 per share and a covenant not to engage in competing business, stock having a market value on that date of $1,164.70 per share, and having failed to report the difference as income in his income-tax return for that year, should not now, after the statute of limitations for the 1922 income has expired, be permitted to contend that the difference between the market price and the cash price he paid was 1922 income and thus profit from his own wrongdoing at the expense of the Government.

The controlling factor in cases presented to the Board of Tax Appeals is the correctness of the result reached by the Commissioner and where all of the facts were before the Board the court may consider points which were not raised before the Board or passed upon by it.

## ARGUMENT

The respondent on December 30, 1922, purchased stock from his employer, the Viscose Company, for $100 per share, which had a fair market value on that date of $1,164.70 per share. He now admits that he did not report the difference as income in his income-tax return for 1922 (R. 40–41); that he did not put anything in his return for the year 1922 or make any statement to the effect that he had received compensation (R. 41), and that he did not regard the difference between the cost and the market value as compensation. He also admits that he reported nothing but cash received in any year (R. 43) and that when he filed his 1922 return he did not consider that he had received any property of value which was not included in the return (R. 46).[2] In 1929 part of the stock was redeemed

[2] Other evidence in the record also reveals clearly that the respondent did not consider, either in 1922 when he purchased the stock or in 1929 when the preferred stock was redeemed, that the difference between the purchase price and the fair market value in 1922 was income to him. In filing his income-tax return for 1929 he reported as a gain from the redemption of the preferred stock the difference between $671,000, the amount received, and $154,166.66, the entire cost

and he now contends that the basis for measuring his profits on the redemption of the stock should be the market price at the time he purchased it, and not the lesser cost of it to him.

Section 213 (a) of the Revenue Act of 1921, *infra,* defines gross income as including gains, profits, and income derived from salaries, wages, or compensation for personal services of whatever kind and in whatever form paid, and provides for including such items in gross income for the taxable year in which received. Section 223 (a) *infra,* provides that every individual having a taxable net income shall make a return under oath "stating specifically the items of his gross income."

Treasury Decision 3435, II–1 Cumulative Bulletin 50, *infra,* promulgated February 7, 1923, provides that where property is sold by an employer to an employee for an amount substantially less than its fair market value, the difference between the cost and the fair market value shall be included in gross income by the employee. It also provides that in computing the gain or loss from

---

of all the shares of the old company. It was not until 1932, when he filed a claim for refund (R. 69, 70), that he first made the claim that the difference between the cost of the stock and the fair market value in 1922 represented additional compensation to him as an officer of the Viscose Company. When he filed his petition with the Board on September 10, 1932, he then for the first time claimed that he received the difference as additional compensation from the Viscose Company and as a consideration for entering into an agreement not to compete.

a subsequent sale of the property its cost shall be deemed to be its fair market value at the date of acquisition.[3]

The plain facts in this case are that the respondent, having escaped paying taxes on the income received through the purchase of the stock, now seeks to take advantage of his own wrong and urges that he should be allowed to compute his profit on the redemption of the preferred stock in accordance with the method outlined in Treasury Decision 3435, even though he failed to report the income as provided therein.

It was the respondent's duty to report the income in his 1922 return, which he failed to do. He now asserts that what he received was income and contends that his profits should be measured on that theory. His failure to report the income constituted, in effect, a representation to the Commissioner that no income had been received, and that representation was relied upon by the Commissioner to the Government's detriment. The re-

[3] *Commissioner* v. *Van Vorst*, 59 F. (2d) 677 (C. C. A. 9th), and *Taplin* v. *Commissioner*, 41 F. (2d) 454 (C. C. A. 6th), hold that Treasury Decision 3435 does not apply to *every* case where property is sold by a corporation to its stockholders at a price substantially less than its fair market value. It was mentioned but not specifically approved or disapproved in *Robinson* v. *Commissioner*, 59 F. (2d) 1008 (C. C. A. 6th). In *Larkin et al.* v. *United States*, 78 F. (2d) 951 (C. C. A. 8th), it was held that it was prospective and not retroactive in its operation and therefore not applicable to taxable years ending prior to February 7, 1923, the date of its issuance.

spondent now, after the statute of limitations has expired, attempts to reverse the position taken by him in 1922. The existence of these elements is all that is required to establish equitable estoppel. *Stone* v. *Bank of Commerce,* 174 U. S. 412; *Kirk* v. *Hamilton,* 102 U. S. 68; *Dickerson* v. *Colgrove,* 100 U. S. 578; *Oklahoma* v. *Texas,* 268 U. S. 252. Regardless, however, of any contentions which the respondent may make to the effect that this case does not meet with the strict textbook or dictionary definition of estoppel, the facts herein clearly show that the respondent is founding his claim on his own omission, concealment, or wrongdoing. The principle that a litigant may not found his claim on his own inequity or wrong was forcefully enunciated by this Court in the case of *Stearns Company* v. *United States,* 291 U. S. 54, wherein the Court said (p. 61):

> Sometimes the resulting disability has been characterized as an estoppel, sometimes as a waiver. The label counts for little. Enough for present purposes that the disability has its roots in a principle more nearly ultimate than either waiver or estoppel, the principle that no one shall be permitted to found any claim upon his own inequity or take advantage of his own wrong. *Imperator Realty Co.* v. *Tull, supra.* A suit may not be built on an omission induced by him who sues.

Two cases in which the facts were almost identical with the facts in the case at bar have been

decided by the Circuit Courts of Appeals for the Tenth and Eighth Circuits, respectively.

In *Bothwell* v. *Commissioner,* 77 F. (2d) 35 (C. C. A. 10th), the taxpayers in 1927 purchased stock of a corporation, of which they were officers, for a price far below its fair market value. In 1928 they sold such stock and contended that the profit on the sale was the difference between the fair market value of the stock on the date they acquired it in 1927 and the selling price in 1928. They claimed that the difference between the price at which they purchased it and its fair market value was compensation for personal services rendered the corporation, but they had not reported such difference in their income-tax returns for the year 1927, and at the time they first made such contention the statute of limitations had expired for that year. In holding that they were estopped to claim the fair market value in 1927 as the basis for measuring the profit on the sale, the court said (p. 37):

> By failing to report such income, each in effect declared that no such income had been received by him. *Crane* v. *Commissioner* (C. C. A. 1) 68 F. (2d) 640, 641. Furthermore, up to the time the amended petitions were filed, each had asserted that the income received by him was capital gain rather than compensation for services. At the time the amended petitions were filed the statute of limitation had run as to the 1927 taxes.

* * * * *

> Darby and Bothwell each having declared in 1927 that no part of the value of the stock was compensation for services, and having continuously asserted from 1928 until after the statute of limitation had run against taxes for 1927, that the whole of the profit derived from the sale of such stock was capital gain, they are now precluded from asserting that a portion of the value of such stock was compensation for services. They are barred from so doing by their wrongful acts and omissions.

In *Larkin et al.* v. *United States,* 78 F. (2d) 951 (C. C. A. 8th), which was decided on August 15, 1935, subsequent to the case at bar, the taxpayers who had purchased from their employer at $100 per share stock having a fair market value of $250 per share subsequently on the sale of that stock, attempted to show a loss by basing the cost on the market value. The court held that the failure of the taxpayers to report the difference in their income-tax returns for the year in which the stock was purchased estopped them from maintaining the suit. At page 954 the court said:

> We think the taxpayers are precluded by their conduct, as shown in their complaints, including exhibits, from maintaining the present suits.

A case similar in all respects to the instant case is that of *Crane* v. *Commissioner,* 68 F. (2d) 640 (C. C. A. 1st), where a taxpayer in 1920 leased his property for a term of years and, in accordance

with the terms of the lease, improvements costing $95,000 were made by the lessee, which were to revert to the lessor upon the termination of the lease. No part of the cost of the improvements was reported as income by the lessor. In 1927 he sold the property, subject to the lease, and in filing his income-tax return for that year, computed the profit from the sale by adding to the March 1, 1913, value the depreciated cost of the improvements made by the lessee. The Commissioner recomputed the profit without making any allowance for the depreciated value of the improvements since they had not been reported as income in his return for the year 1920. The Circuit Court of Appeals in affirming the Board and the Commissioner said (p. 641):

> This obligation to report and pay a tax was never performed, and cannot now be enforced against the petitioner, because it is barred by the statute of limitations. The petitioner urges that he is entitled to the benefit of the statute of limitations, and so he is. The obligation can no longer be enforced. But the failure, however innocent, to report this income, consituted in effect a statement that no such income was rereceived, and the government, in reliance thereon, failed to receive the amount of any such tax as might have resulted if the petitioner's returns had been accurate. The statutes and regulation should not be construed to entitle a taxpayer to the benefit

> of an expenditure made by his lessee, when the taxpayer has failed to report or to pay a tax in the appropriate year or years upon the income received by virtue of the lessee's expenditure.[4]

Other cases in which the doctrine of estoppel has been applied to taxpayers who failed to report income or who sought to change their position to the detriment of the Government are *Askin & Marine Co.* v. *Commissioner,* 66 F. (2d) 776 (C. C. A. 2d); *Haag* v. *Commissioner,* 59 F. (2d) 514 (C. C. A 7th); *Commissioner* v. *Moore,* 48 F. (2d) 526 (C. C. A. 10th); *Edward G. Swartz, Inc.* v. *Commissioner,* 69 F. (2d) 633 (C. C. A. 5th).[5]

---

[4] The court below did not agree with the majority opinion in the above case but thought that the concurring opinion of Judge Morton was the sounder argument. Judge Morton repudiated the estoppel theory and based his concurring opinion on the theory that the taxpayer had elected in good faith to let his gain or loss ride along until the termination of the lease and that the sale of the property terminated the lease, and the gain thereupon became taxable as income. While the concurring opinion reaches the correct result, the conclusion is based upon the wrong premise, because a taxpayer may not elect the year in which income shall be taxed. The Revenue Acts, without exception, tax incomes to the recipient in the year in which it is actually received or accrued; and a taxpayer who is in receipt of income may not defer reporting it until a later year. *North American Oil* v. *Burnet,* 286 U. S. 417, 424; Section 213 (a) of the Revenue Act of 1921; and Article 51 of Regulations 62.

[5] See also *Wheelock* v. *Commissioner,* 77 F. (2d) 474 (C. C. A. 5th); *Commissioner* v. *Liberty Bank & Trust Co.,* 59 F. (2d) 320 (C. C. A. 6th); *Matern* v. *Commissioner,* 61 F. (2d) 663 (C. C. A. 9th); *Giant Furniture Co.* v. *United States,* 9

The court below, in holding that the respondent was not estopped to set up as a cost basis the market value of the old stock which he acquired in 1922, cited *United States* v. *S. F. Scott & Sons,* 69 F. (2d) 728 (C. C. A. 1st), and *Helvering* v. *Brooklyn City R. Co.,* 72 F. (2d) 274 (C. C. A. 2d). Both cases are, however, quite different from the present one. In the *Scott* case, *supra,* a corporation paid a tax which the Commissioner had assessed against it, but which should have been assessed against an individual. The court found that the corporation did nothing and said nothing which misled the Government as to the facts, and that "the error originated in the misapprehension of the Commissioner as to the law applying to the assessment of the tax in question." Of course, such a case is not one calling for the application of the doctrine of estoppel because the Commissioner was not misled.

In *Helvering* v. *Brooklyn City R. Co., supra,* the question involved was whether the taxpayer was estopped to contend that a return for the calendar year 1921 should have been a return for a fiscal

---

F. Supp. 585 (C. Cls.); *Adler* v. *Commissioner*, 77 F. (2d) 733 (C. C. A. 5th); *Continental Products Co.* v. *Commissioner*, 66 F. (2d) 434 (C. C. A. 1st); *Moran* v. *Commissioner*, 67 F. (2d) 601 (C. C. A. 1st); *Putnam Nat. Bank* v. *Commissioner*, 50 F. (2d) 158 (C. C. A. 5th); *Naumkeag Steam Cotton Co.* v. *United States*, 2 F. Supp. 126 (C. Cls.), certiorari denied, 289 U. S. 749; *Mahoning Investment Co.* v. *United States*, 3 F. Supp. 622 (C. Cls.), certiorari denied, 291 U. S. 675; *Hartwell Mills* v. *Rose*, 61 F. (2d) 441 (C. C. A. 5th).

year. The court held that there was no estoppel. But in that case a cursory examination of the taxpayer's books would have disclosed the fact that they were kept on a fiscal year basis, and the statute required that the return be made on the same basis as the books. It was not shown that the tax for earlier years would have been greater if the returns had been properly filed, and in the only year in which it might have been said that the Government was injured it was not shown whether the question was raised so late as to prevent a correction.

The same court (the court below), in the earlier case of *Askin & Marine Co.* v. *Commissioner, supra,* held that where a taxpayer had charged off certain debts as worthless in one year and subsequently collected them, he would not be heard to say that they were not worthless in that year for the purpose of eliminating from his return the income represented by the collections in a later year.

If the Court should concur in the opinion of the court below, that the respondent is not estopped, nevertheless, he should not be entitled to a refund of taxes already paid. The situation then presented in the instant case would not be materially different from that involved in *Bull* v. *United States,* 295 U. S. 247. There the Commissioner had treated an item as capital for estate-tax purposes and also as income for income-tax purposes. This Court held that the item was properly taxable as

income and that it did not form a part of the gross estate. However, the statute of limitations had run against the filing of a suit for recovery of the estate tax, but it was held that the claim of the Commissioner for additional income taxes was in the nature of a suit by the United States, and as the claim arose out of the same transaction, the taxpayer was entitled to recoup the amount mistakenly collected as an estate tax. Since the income and profits involved in the present case arise from the same transaction, the Commissioner, under the authority of *Bull* v. *United States, supra,* should be entitled to a recoupment of the taxes which should have been paid for the year 1922. As was said in that case (p. 262):

> Such a defense is never barred by the statute of limitations so long as the main action itself is timely.

---

The issue of estoppel was first raised in the court below on reargument, but no question was raised either by the respondent or by the court as to the failure of the pleadings to present the issue or a plea of estoppel. At common law it was not necessary to plead estoppel *in pais, Feinberg* v. *Allen,* 208 N. Y. 215; *Boone* v. *Citizens Bank & Trust Co.,* 154 Tenn. 241; *Shelton* v. *Southern Railway Co.,* 255 Fed. 182, Bigelow on Estoppel, 5th Ed. p. 699,[6]

---

[6] That is still the law in some jurisdictions (see *Shutter Bar Co.* v. *Zimmerman,* 110 Md. 313; *Feinberg* v. *Allen,*

and it need not be pleaded in proceedings which do not contemplate formal technical pleading. *Gilcrest Co.* v. *Des Moines,* 157 Iowa 525, 137 N. W. 1072. Several decisions indicate that the Board of Tax Appeals, as an administrative body, is not bound by strict rules of pleading and that the Circuit Court of Appeals had authority to consider the estoppel issue. In *Board of Tax Appeals* v. *United States ex rel. Shults Bread Co.,* 37 F. (2d) 442, certiorari denied, 281 U. S. 731, the Court of Appeals for the District of Columbia held that mandamus should not issue to compel the Board to enter judgment by default for the taxpayer, when the Commissioner had not filed his answer in time. See also *Greengard* v. *Commissioner,* 29 F. (2d) 502 (C. C. A. 7th). In *Hanby* v. *Commissioner,* 67 F. (2d) 125 (C. C. A. 4th), it was held that a question of fraud was properly put in issue although not affirmatively alleged in the Commissioner's answer, where it was obvious to petitioner that fraudulent conduct on his part formed the basis of the

---

*supra; Intertype Corp.* v. *Pulver,* 2 F. Supp. 4 (S. D. Fla.), affirmed, 65 F. (2d) 419 (C. C. A. 5th), certiorari denied, 290 U. S. 660; *Bemis* v. *Pacific Coast Casualty Co.,* 125 Minn. 54), while in others it must be pleaded if there is opportunity. *Laughinghouse* v. *Insurance Co.,* 200 N. C. 434; *Hall & Farley* v. *Henderson,* 126 Ala. 449; *Mabury* v. *Louisville & J. Ferry Co.* 60 Fed. 645 (C. C. A. 7th); *Promis* v. *Duke,* 208 Cal. 420; *Walker* v. *Fireman's Fund Ins. Co.,* 114 Ore. 545. Each State has its own rule, influenced to a considerable extent by its statutes concerning pleading.

Commissioner's determination. Moreover, both the Board and the Circuit Court of Appeals considered the question of estoppel in *Crane* v. *Commissioner, supra,* although the issue was not raised in the pleadings. In *Helvering* v. *General Utilities & Operating Co.,* 74 F. (2d) 972 (C. C. A. 4th), it was held that the controlling factor in this class of cases is the correctness of the result reached by the Commissioner and that points not raised before the Board may be considered by the court. At page 975 the court said:

> As to the second point raised by the petitioner, it is contended on behalf of the respondent that this point, not having been raised before the Board, cannot now be urged before us for the first time. We cannot agree with this conclusion. The correctness of the result reached by the Commissioner of Internal Revenue in determining the deficiency is the controlling factor, and not the method by which it was determined nor the reasons given for the determination. *Hughes* v. *Commissioner* (C. C.) 38 F. (2d) 755; *Hurwitz* v. *Commissioner* (C. C. A.) 45 F. (2d) 780; *Helvering* v. *Gregory* (C. C. A.) 69 F. (2d) 809.

It is clear that the question was properly before the court.

CONCLUSION

It is therefore respectfully submitted that the decision of the court below should be reversed.

STANLEY REED,
*Solicitor General.*
FRANK J. WIDEMAN,
*Assistant Attorney General.*
GOLDEN W. BELL,
*Assistant Solicitor General.*

ELLIS N. SLACK,
*Special Assistant to the Attorney General.*
JOHN R. BENNEY,
*Attorney.*

NOVEMBER 1935.

## APPENDIX

Revenue Act of 1921, c. 136, 42 Stat. 227, 237, 250:

SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items (except as provided in subdivision (e) of section 201) shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; * * *.

SEC. 223. (a) That the following individuals shall each make under oath a return stating specifically the items of his gross

income and the deductions and credits allowed under this title—

(1) Every individual having a net income for the taxable year of $1,000 or over, if single, or if married and not living with husband or wife;

(2) Every individual having a net income for the taxable year of $2,000 or over, if married and living with husband or wife; and

(3) Every individual having a gross income for the taxable year of $5,000 or over, regardless of the amount of his net income.

* * * * *

Revenue Act of 1928, c. 852, 45 Stat. 791, 816, 818:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * *

(3) STOCK FOR STOCK ON REORGANIZATION.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

* * * * *

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at

least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

* * * * *

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

(6) TAX-FREE EXCHANGES GENERALLY.—If the property was acquired upon an exchange described in section 112 (b) to (e), inclusive, the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted by section 112 (b) to be received without the recognition of gain or loss, and in part of other property, the basis provided in this paragraph shall be allocated between the properties (other than money) received, and for

the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. This paragraph shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it;

* * * * *

Treasury Decision 3435, II-1 Cumulative Bulletin 50:

INCOME TAX—SALE OF PROPERTY AT AN AMOUNT SUBSTANTIALLY LESS THAN ITS FAIR MARKET VALUE

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF
INTERNAL REVENUE,
*Washington, D. C.*

*To collectors of internal revenue and others concerned:*

Where property is sold by a corporation to a shareholder or member, or by an employer to an employee, for an amount substantially less than its fair market value, such shareholder or member of the corporation or such employee shall include in gross income the difference between the amount paid for the property and the amount of its fair market value. In computing the gain or loss from the subsequent sale of such property its cost shall be deemed to be its fair market value at the date of acquisition.

D. H. BLAIR,
*Commissioner of Internal Revenue.*

Approved February 7, 1923.

A. W. MELLON,
*Secretary of the Treasury.*

U. S. GOVERNMENT PRINTING OFFICE: 1923

FILE COPY

FILE
AUG 7
CHARLES ELMORE

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1935.

No. 173.

GUY T. HELVERING, Commissioner of Internal Revenue,
*Petitioner,*

*v.*

SAMUEL A. SALVAGE,
*Respondent.*

## RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

JOHN G. JACKSON,
*Solicitor for Respondent.*

# INDEX.


| | PAGE |
|---|---|
| Opinions below | 1 |
| Jurisdiction | 1 |
| Questions presented | 2–3 |
| Statement | 3–4 |
| Argument | 4–10 |


## CITATIONS.

CASES:


| | |
|---|---|
| Adler *v.* Commissioner, C. C. A. 5th, May 22, 1935 | 8 |
| Askin & Marine Co. *v.* Commissioner, 66 F. (2) 776 | 7 |
| Board of Tax Appeals *v.* United States ex rel. Shults Bread Co., 37 F. (2) 442 | 9 |
| Bothwell *v.* Commissioner, C. C. A. 10th, April 10, 1935 | 6–7 |
| Commissioner *v.* Liberty Bank & Trust Co., 59 F. (2) 320 | 7 |
| Crane *v.* Commissioner, 68 F. (2) 640 | 6, 9 |
| Giant Furniture Co. *v.* United States, 9 F. Supp. 585 | 7 |
| Greengard *v.* Commissioner, 29 F. (2) 502 | 9 |
| Helvering *v.* Brooklyn City R. Co., 72 F. (2) 274 | 9 |
| Hanby *v.* Commissioner, 67 F. (2) 274 | 9 |

PAGE

Mahoning Investment Co. *v.* United States, 3 F. Supp. 622 ..... 8

Naumkeag Steam Cotton Co. *v.* United States, 2 F. Supp. 622 ..... 8

Newaygo Portland Cement Co. *v.* Helvering, App. D. C., April 15, 1935 ..... 8

Stearns Co. *v.* United States, 291 U. S. 54 ..... 5

Swartz, Edward G., Inc. *v.* Commissioner, 69 F. (2) 633 ..... 6

Swiss Oil Co., 32 B. T. A. decided June 14, 1935 ... 5, 9

The Viscose Company, 3 B. T. A. 444 ..... 5

United States *v.* S. F. Scott & Sons, 69 F. (2) 728 .. 4, 7

STATUTES:

Revenue Act 1924
Section 907 (a) ..... 8

Revenue Act 1926
Section 1000 ..... 8

Revenue Act 1928
Section 601 ..... 8

MISCELLANEOUS:

Reg. 62, Article 1567 ..... 2

T D 3439 ..... 2

B. T. A. Rule 14 ..... 8, 9

B. T. A. Rule 20 ..... 9

IN THE

# SUPREME COURT OF THE UNITED STATES,

## OCTOBER TERM 1935.

**No. 173.**

GUY T. HELVERING, Commissioner of Internal Revenue,
*Petitioner,*
*v.*
SAMUEL A. SALVAGE,
*Respondent.*

**RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.**

The above named respondent submits that the prayer of the Commissioner for a writ of certiorari to review the judgment of the Circuit Court of Appeals for the Second Circuit should not be granted.

### Opinions Below.

The opinion of the Board of Tax Appeals (R., 49-56) is unreported. The opinion of the Circuit Court of Appeals (R., 135) is reported in 76 F. (2d) 112.

### Jurisdiction.

The judgment of the Circuit Court of Appeals reversing the decision of the Board of Tax Appeals in part and affirming it in part was entered on March 25, 1935 (R., 140). The jurisdiction of this court is invoked under Section 240-a of the Judicial Code (as amended by the Act of February 13, 1925).

## Question Presented.

The taxpayer on December 30, 1922, purchased stock pursuant to the contract in evidence and simultaneously exchanged it for preferred and common stock of the holding company. In his return for the year 1922 he did not report as income any difference between the price paid and the real value of the stock (as subsequently found). This was due to an innocent mistake of law (R., 138). T. D. 3435, the first statement of the so-called "bargain purchase" rule, was not issued until February 1923. The selling corporation did not in its 1922 income tax return deduct any amount representing such difference in value as an expense of business (R., 76).

Upon the filing of taxpayer's 1929 return the Statute of Limitations had run against claims based upon the year 1922.

In his 1929 return the taxpayer reported as income the difference between the amount paid by him for the stock and the amount received upon the redemption of the preferred stock. He relied on Article 1567, Regulations 62, to the effect that where two classes of stock are received in exchange for one class *and no fair apportionment is practicable* (our italics) no profit is realized until the entire cost is recovered.

The transaction is summarized as follows (R. 136):

| *Paid for 1500 shares Viscose Company 1922* | | *Received for 1500 shares Viscose Company 1922* |
|---|---|---|
| $150,000 | | 6000 shares Amer. Viscose pfd. |
| | | 7500 " " " common |

| *Received for 7500 shares American Viscose pfd. 1929* | *Returned as taxable gain 1929* |
|---|---|
| $660,000 | $510,000 |

leaving the taxpayer possessed of 7500 shares of the common stock the entire proceeds of which would be subject to tax.

The Commissioner held this theory incorrect, found a valuation, made an apportionment, and assessed a deficiency.

In his petition to the Board the taxpayer took the position:

(1) That the theory of his return was correct, that no valuation or apportionment was practicable, and no deficiency should have been assessed.

(2) If the Commissioner was correct and a valuation and apportionment was practicable, then the difference in value represented compensation under the contract and he was entitled to a refund (R., 53).

Both the Board and the Circuit Court sustained the Commissioner upon the question of value and apportionment and the Circuit Court sustained the taxpayer in part on the claim for refund.

The Commissioner did not plead estoppel nor is it referred to in the Board's opinion. It was first urged by him before the Circuit Court.

The question presented is whether under the above circumstances the taxpayer is estopped from claiming that he received as income in the year 1922 and as compensation under the contract in evidence the difference between the amount paid by him in cash for the stock and its value as found by the court.

## Statement.

The statement of facts in the petition is accurate except as to the statement on page 5 thereof that the theory of the taxpayer was that the difference between the cost of the stock and the fair market value represented compensation for services. Assignment of error (d) (R., 4-5) states that such difference was additional compensation to him *pursuant to contract* (our italics). Paragraph V-(a) (R., 5-6) states the substance of the contract and a copy thereof was annexed to the petition (R., 19-21). The question of whether such compensation was received for services rendered or to be rendered, or for refraining from comptition,

was to be determined from the contract itself and the relevant surrounding circumstances. At no time did the taxpayer confine his claim to the former.

## Argument.

The Commissioner specified that the Circuit Court erred:

In failing to hold that the taxpayer was estopped to claim that the basis for measuring the gain from the redemption of his new stock in 1929 was the fair market value of the old stock acquired in 1922, by his failure to report the difference between the cost and fair market value as income for 1922.

He presents the following arguments in support of his contention that the writ should be allowed:

(1) That all of the elements required to establish equitable estoppel or estoppel *in pais* exist in this case.

(2) The decision of the court below is directly opposed to decisions of the Circuit Courts of other circuits and of this Court.

(3) That the failure to plead estoppel did not preclude its consideration by the court.

## POINT I.

**The necessary elements of estoppel did not exist in this case.**

The elements necessary to sustain a claim of estoppel in an income tax case are correctly set forth in *U. S.* v. *S. F. Scott & Sons*, 69 F. (2d) 728, 732, as follows:

> "(1) There must be a false representation or wrongful misleading silence.
>
> (2) The error must originate in a statement of fact and not in an opinion or in a statement of law.
>
> (3) The person claiming the benefits of estoppel must be ignorant of the true facts.

(4) He must be adversely affected by the acts or statements of the person against whom an estoppel is claimed."

The tests laid down in that case are not met in the instant case for (1) the silence was in no sense wrongful, (2) it was based upon an erroneous opinion as to the law (R., 138), and (3) there is nothing in the record to show that petitioner or his predecessors were adversely affected.

In the case of *The Viscose Company*, 3 B. T. A. 444, the Board had held it impossible to determine the value of the assets of the company.

While it is true that the taxpayer did not return the additional income as such, there is nothing to show a loss of tax thereby. Petitioner did not put the 1922 return of the taxpayer in evidence, although he might have done so. The record (R., 76) also shows that The Viscose Company did not deduct the amount in controversy as salary in its return. Had it done so the Treasury would presumably have been deprived of 12½% of the amount. To sustain petitioner's claim might result not in preventing the Treasury from obtaining taxes which should have been paid to it, but in allowing it to be unjustly enriched. If the 1922 liability was not correctly determined, this is no reason to seek to correct the error by an erroneous determination for a subsequent year. *Swiss Oil Co.*, 32 B. T. A., June 14, 1935. There is no evidence that the Commissioner relied on the 1922 return.

The only one of the cases relied on by petitioner to sustain his contention that all the elements of estoppel exist in this case which might be considered in point is *Stearns Co.* v. *U. S.* 291 U. S. 54. That case is clearly distinguishable. It involved a deliberate affirmative request by the taxpayer to the Commissioner to withhold collection, which request the Commissioner granted. After the statute had run the taxpayer endeavored to take advantage of the statute. The court held he was estopped from so doing.

The instant case involves no such affirmative act nor any such misleading of the Commissioner.

A distinction which must be emphasized and should be observed in connection with all of the Commissioner's arguments is the following:

The taxpayer filed a return in good faith basing his tax upon what he believed to be the law (R. 138). The theory adopted by him would eventually have given the Government a tax upon the full difference between the cost of $100. per share and the total proceeds. The Commissioner rejected this theory. The taxpayer was defeated in his contention and the Commissioner sustained. The taxpayer now merely seeks to carry the Commissioner's theory, which he has been forced to adopt, to its logical conclusion. If any detriment to the Government has arisen, it arises not from any position deliberately taken by the taxpayer but from its own action.

## POINT II.

**No conflict is shown between the decision in this case and decisions in other Circuits or in this Court.**

The basis of claim for the writ is that the decision of the Circuit Court is directly opposed to decisions in other circuits, principally *Crane* v. *Commissioner,* 68 F. (2d) 640, *Bothwell* v. *Commissioner,* (C. C. A. 10) 1935 C. C. H. Vol. 3, Par. 9302, and *Edward G. Swartz Inc.* v. *Commissioner,* 69 F. (2d) 633.

In the *Crane* case an examination of the record, the Circuit Court decision, and the decision of the Board of Tax Appeals, 27 B. T. A. 360, shows that estoppel was not mentioned at any time (this despite the statement at the bottom of page 15 of the petitioner's brief). Certain language in the majority opinion might be construed as holding that estoppel applied, but the language is equally consistent

with the theory of election. The case of *U. S.* v. *S. F. Scott & Sons, supra,* which stated the principles upon which estoppel is based, is entirely consistent with the instant case and was decided by the First Circuit. No conflict, therefore, exists between the two jurisdictions.

The *Bothwell* case is distinguishable in several respects:

(1) Estoppel was pleaded, while it was not here.

(2) It is not apparent whether an error in the return in respect to compensation for services originated in a statement of fact or an opinion of law. Here the error was clearly one of law.

(3) The court held that compensation had not in fact been received, hence the language in respect to estoppel was unnecessary to the decision. Here the court held compensation had been so received.

(4) The statute ran during the pendency of the proceeding. If at its commencement the taxpayer had set forth the claim as finally made, the Commissioner would have been in a position to protect himself. Here the statute had run before the controversy arose.

In the *Swartz* case, entirely aside from differences in the facts, the court stated that it was unnecessary to consider the question of estoppel and its language in respect to it was clearly dictum.

The other cases relied on by the Commissioner but not analyzed are distinguishable in respect to the act of the taxpayer which prevented the collection of tax before the statute ran.

In *Askin & Marine Co.* v. *Commissioner,* 66 F. (2d) 776, *Commissioner* v. *Liberty Bank & Trust Co.,* 59 F. (2d) 320 and *Giant Furniture Co.* v. *U. S.,* 9 F. Supp. 585, there had been affirmative claims for deductions in previous returns, which claims had been allowed, and the taxpayers sought, after the statute had run, to claim that such deductions in

such years were improper and should be attributed to subsequent years. *Newaygo Co.* v. *Helvering,* 1935 C. C. H. Vol. 3, Par. 9320, involves the same principle.

In *Naumkeag Steam Cotton Co.* v. *U. S.,* 2 F. Supp. 126 and *Stearns Co.* v. *U. S., supra,* there were affirmative requests by the taxpayers which induced Commissioner to withhold collection until after the statute had run.

In *Adler* v. *Commissioner,* C. C. A. 5th, 1935 C. C. H. Vol. 3, Par. 9397, the taxpayer included the amount in controversy as income in his return for a certain year and after the statute had run against a previous year amended and claimed that it had been received in such previous year.

In *Mahoning Investment Co.* v. *U. S.,* 3 F. Supp. 622, the parent company, with full knowledge of the facts, paid a tax which had been erroneously assessed against it instead of properly against a subsidiary, and after the statute had run sought a refund.

In each instance there was an affirmative representation upon which the Commissioner relied.

## POINT III.

**The Commissioner cannot claim the benefit of estoppel as he did not plead the same.**

The Board has power to prescribe its rules of practice and procedure. Section 907-(a) Revenue Act of 1924, as amended by Section 1000, Revenue Act of 1926 and Section 601 of the Revenue Act of 1928. Rule 14 of the Board requires the Commissioner to file an answer which shall contain

> "A specific admission or denial of each material allegation of fact contained in the petition and a statement of any facts upon which the Commission relies for defense or for affirmative relief, or to sustain any issue raised in the petition in respect of which issue the burden of proof is by statute placed on the Commission."

The Board in a recent decision held that estoppel must be pleaded and proven. *Swiss Oil Co.* v. *Commissioner, supra.* This was also held in *Helvering* v. *Brooklyn City Ry. Co.*, 72 F. (2d) 274. The Commissioner's statement in the last sentence of the footnote at page 15 of the petition that both the Board and the Circuit Court considered the question of estoppel in the *Crane* case, *supra,* is not supported by the record. The Board dealt with the case on a theory that the taxpayer had not met the burden of proof, and its opinion makes no mention of estoppel. The opinion of the Circuit Court does not use the word "estoppel" and is consistent with a decision on the basis of election. The cases relied on by the Commissioner are not in point.

*Board of Tax Appeals* v. *U. S. ex rel. Schuts Bread Co.*, 37 F. (2d) 442, dealt with a construction of Rule 20 of the Board which has no analogy to Rule 14.

*Greengard* v. *Commissioner*, 29 F. (2d) 502, related to the verification of an answer by the Commissioner and the Court held such verification was not required.

*Hanby* v. *Commissioner*, 67 F. (2d) 125, dealt with the same rule but was decided prior to the amendment by which the rule was put in its present form.

The inference, if any, to be drawn from all of these cases is that the rules will be strictly interpreted.

Nor is the Commissioner's claim that he had no reason or opportunity to plead estoppel sound. His statement in the first sentence of footnote 5, on page 13 of the petition, is not in accord with the facts. Paragraph IV-(d) (R. 4) of the petition specifically claims error in not holding that the difference in value was compensation to the taxpayer under the contract. It does not say compensation to the taxpayer for services. The contract was not to compete and was summarized (R. 6) and annexed as an exhibit (R. 19-21). No change was made in this allegation throughout. It was met by a general denial. The claim was clear and specific and if the Commissioner intended to claim estoppel he was required by Rule 14 to set it up in his answer.

## CONCLUSIONS.

The writ should not be allowed because

1. The elements necessary to establish estoppel are not present.

2. There is no conflict of decision.

3. Failure to plead the estoppel bars the claim.

4. No question of public importance is involved.

JOHN G. JACKSON,
*Solicitor for Respondent.*

August, 1935.

FILE COPY

Office Supreme Court
FILED
NOV 14
CHARLES ELMORE

# Supreme Court of the United States

**OCTOBER TERM, 1935.**

---

**No. 173**

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

*Petitioner,*

*vs.*

SAMUEL A. SALVAGE.

---

**No. 280**

SAMUEL A. SALVAGE,

*Petitioner,*

*vs.*

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

---

## BRIEF FOR SAMUEL A. SALVAGE, Petitioner.

---

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

JOHN G. JACKSON,
*Attorney for Petitioner,*
SAMUEL A. SALVAGE.

WILLIAM H. WHITE, JR.,
GEORGE B. BROOKS,
*Of Counsel.*

# INDEX.


| | PAGE |
|---|---|
| Opinions Below | 1 |
| Jurisdiction | 1 |
| Questions Presented | 2 |
| Statement of Case | 3 |
| Specification of Errors | 7 |
| Summary of Argument | 8 |
| Argument | 9 |

## CITATIONS.


| CASES: | PAGE |
|---|---|
| *Avery* v. *Commissioner*, 22 F. (2) 6 | 28 |
| *Brant* v. *Virginia Coal & Iron Co., et al.*, 93 U. S. 326 | 13 |
| *Burns* v. *Commissioner*, 30 B. T. A. 163 | 22 |
| *Crary* v. *Dye*, 208 U. S. 515 | 14 |
| *Gilmer* v. *Poindexter*, 10 Howard 257 | 10 |
| *Griffiths* v. *Commissioner*, 70 F. (2) 946 | 28 |
| *G. & K. Mfg. Co.* v. *Commissioner*, 76 Fed. 2d 454 | 26 |
| *Helvering* v. *General Utilities & Operating Co.*, 74 F. (2) 972) | 28 |
| *Helvering* v. *Kendrick Coal & Dock Co.*, 72 F. (2) 330 | 21 |
| *Helvering* v. *Brooklyn City Ry. Co.*, 72 F. (2d) 274 | 10 |
| *Henritze* v. *Commissioner*, 28 B. T. A. 1173 | 21 |
| *Hobbs* v. *McLean*, 117 U. S. 567 | 14 |
| *Ithaca Trust Co.* v. *United States*, 299 U. S. 151 | 26 |
| *Lincoln Bryant* v. *Commissioner of Corporations*, 197 N. E. 504 | 22 |
| *Markle* v. *Commissioner*, 10 B. T. A. 763 | 23, 24 |
| *Miller Industries* v. *Commissioner*, 61 Fed. (2d) 412 | 27 |
| *Newman* v. *Commissioner*, 40 Fed. (2d) 225 | 21 |
| *Oklahoma* v. *Texas*, 268 U. S. 252 | 14 |
| *Phillips* v. *Commissioner*, 283 U. S. 589, 600 | 17, 28 |
| *Rodrigues* v. *Edwards*, 40 Fed. (2d) 408 | 22 |

PAGE

*Schneider* v. *Duffy*, 43 Fed. (2d) 642..... 22
*Sugar Creek Coal & Mining Co.*, 31 B. T. A. 344... 10, 18
*Swiss Oil Co.* v. *Commissioner*, 32 B. T. A., decided June 14, 1935..... 9

*Tex-Penn Oil Co.*, 28 B. T. A. 917..... 22
*The Viscose Company*, 3 B. T. A. 444..... 16
*Tricou* v. *Commissioner*, 68 F. (2) 280..... 28

*Virginia Ry. Co.* v. *Mullens*, 271 U. S. 220..... 12

*Wilber Nat. Bank* v. *United States*, 79 L. E. 405... 14
*Wilson* v. *Bowers*, 57 Fed. (2) 682..... 23
*Wright* v. *Commissioner*, 50 Fed. (2) 727..... 22

TEXTBOOK:

Bigelow on Estoppel—Sixth Edition..... 14

STATUTES:

Judicial Code, Sec. 240-a, as amended..... 2
Act of February 26, 1926, Chap. 27, Sec. 1003, 44 Stat. 110 ..... 2
Revenue Act of 1924, Sec. 907-(a), as amended.. 10

MISCELLANEOUS:

Regulations 62, Article 1576..... 5
T. D. 3435, II-1 C. B. 50..... 15
Rule 14 Board of Tax Appeals..... 10
Regulations 86, Article 22 (a)-1..... 15
Regulations 62, Article 1711..... 17

SUPREME COURT OF THE UNITED STATES,
OCTOBER TERM, 1935.

---

**No. 173**

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
*Petitioner,*

*vs.*

SAMUEL A. SALVAGE.

---

**No. 280**

SAMUEL A. SALVAGE,
*Petitioner,*

*vs.*

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

---

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

---

## Opinions Below.

The opinion of the Board of Tax Appeals (R. 28-32) is unreported.

The opinion of the Circuit Court of Appeals (R. 74-78) is reported in 76 Fed. (2d) 112.

## Jurisdiction.

The judgment of the Circuit Court of Appeals reversing the decision of the Board of Tax Appeals in part and affirming it in part was entered on March 25, 1935 (R.

78). Writs of certiorari were granted on cross petitions on October 14, 1935 (R. 79, 80). The jurisdiction of this court is invoked under Section 240-a of the Judicial Code as amended by the Act of February 13, 1925, and Section 1003 of the Act of February 26, 1926, Chapter 27, 44 Stat. 110.

## Questions Presented.

The questions before the court involve the correct determination of the income tax liability of the petitioner Salvage for the year 1929. The Commissioner, having audited the taxpayer's return, asserted a deficiency of $12,005.38. The taxpayer denied the existence of the claimed deficiency and claimed a refund of $63,750.

The Board of Tax Appeals sustained the Commissioner. The Circuit Court of Appeals in part affirmed the Board of Tax Appeals and reversed its decision to an extent which allowed a refund, although not the full amount claimed. Both parties petitioned for writs of certiorari for a review by this Court of the parts of the judgment of the Circuit Court of Appeals which were adverse to their respective claims, which petitions were granted. The questions are:

1. In No. 173, whether the taxpayer is estopped to claim that the difference between the market value of 1500 shares of stock as of December 30, 1922, and their cash cost to him constituted taxable income to him for 1922, and hence that the fair market value of these shares and not their cash cost is the basis to be used in measuring gain from the disposition of a part of the shares in 1929, no income from the transaction having been reported in 1922.

2. In No. 280, whether the proper cost base of the preferred stock redeemed in 1929 should be arrived at by an apportionment of (1) the true value of or (2) the cash paid for the stock.

3. In No. 280, whether the Circuit Court of Appeals exceeded its jurisdiction in making the finding of such value.

## Statement of Case.

Samuel A. Salvage, commencing about 1910 (p. 36) and through the entire period involved in this proceeding, was an employee and officer of The Viscose Company, or its predecessors, a corporation engaged in the manufacture and sale of rayon yarn (pp. 23, 37).

The growth of the business was phenomenal. Its production increased from 320,000 pounds of yarn in 1911 to over 19,000,000 pounds in 1922 and to over 75,000,000 pounds in 1933 (pp. 38, 39, 40). In recognition of his value to the company, the shareholders in 1919 offered to increase his compensation but Salvage failed to take up the offer (pp. 38, 43). To remedy this, the stockholders and Directors, on December 15, 1922 authorized an increase of 4,000 in the corporation's outstanding shares and the sale of 1500 of these shares to Mr. Salvage at par (pp. 48-50).

The contract of sale provided as follows:

> "Whereas the Company has, in consideration of the agreement of Salvage hereinafter set forth, sold to him or his nominees 1,500 shares of its capital stock at par, and has issued certificates therefor as directed by Salvage.
>
> Now This Agreement Witnesseth:
>
> 1. That Salvage does hereby agree to and with the Company that the said Company shall have the right to repurchase from him or his nominees, and he does hereby undertake, on behalf of himself, his heirs, executors, administrators, and assigns, to procure for and deliver to the said Company for repurchase at par the following proportions of the said 1,500 shares:
>
> At any time during the year 1923, five-sevenths;
> At any time during the year 1924, four-sevenths;
> At any time during the year 1925, three-sevenths;

At any time during the year 1926, two-sevenths;
At any time during the year 1927, one-seventh of the said 1,500 shares.

2. Salvage does further hereby agree to and with the Company that he will not at any time during his life in any part of the United States of America, except the States of Utah, Nevada, and New Mexico, Canada, the United Kingdom of Great Britain, or the Free State of Ireland, directly or indirectly, alone or in partnership, or as a Director or other Officer of a corporate body or as an Agent or otherwise howsoever, carry on or be engaged in any trade, business, or occupation for the manufacture or production of artificial silk, rayon, or Viscose, or of any material, goods, or articles from Viscose in any form, nor enter into the service of or, directly or indirectly, assist or act for any person, firm, or corporation in such trade or business or manufacturing, or contemplating the manufacture of, artificial silk or rayon, without the express written consent of the said Company."

(Exhibit C, p. 10, annexed to the petition, repeated as Exhibit A, p. 14, to Stipulation of Facts)*.

At the same time a contract of employment dated back to January 1, 1922, was entered into (Exhibit 5, p. 57). It should be noted that the expiration dates of the employment contract and of the stock options are the same. The minutes of the stockholders' and directors' meetings of December 15, 1922, contain no mention of the stock repurchase contract but with respect to employment the Directors' minutes state: "Resolved that the company enter into a new service agreement with * * * Mr. Samuel A. Salvage dating as from January 1st, 1922, for a period of six years in the form presented to the meeting * * *." (p. 50)

On December 30, 1922, the same day that the stock contract was entered into, a new company was organized called American Viscose Corporation. That company issued four

* This contract superseded the document printed at pages 54 and 55 of the Record. See paragraph 3 of Stipulation, p. 13, and Statement of Counsel, p. 16.

shares of its 7% preferred stock, callable at $110. per share, and five shares of its common stock in exchange for each share of stock of the old Viscose Company. (Stipulation of Facts, paragraphs 1 and 2, pp. 12 and 13.) By this exchange, the taxpayer became the owner of 6100 shares of preferred stock and 7615 shares of the common stock of the new company.* The repurchase rights reserved by the old company in the contract of December 30th were extended to these shares by an exchange of letters (Exhibits 3 and 4, p. 56). In 1929 American Viscose Corporation redeemed all of its preferred stock at its call price of $110. per share and Mr. Salvage received $671,000. for the 6,100 shares held by him (Petition V (c), p. 4; Answer V (c), p. 12).

The issue to be decided is what part of this sum of $671,000. is taxable income. The taxpayer took the position that it was impracticable to apportion between the preferred and common stock of the new company the percentage of the cost of his original stock to be attributed to each (Article 1576, Regulation 62) and his return for the year 1929 showed the transaction as follows (p. 27):

SCHEDULE D—CAPITAL NET GAIN OR LOSS FROM SALE OF ASSETS HELD MORE THAN 2 YEARS:

| 1. Kind of Property | 2. Date acquired | 3. Date Sold | 4. Amt. Received | 6. Cost, etc. | 8. Net Gain, etc. |
|---|---|---|---|---|---|
| 6100 Amer. Viscose Co: pfd. stock redeemed ..... | 1919–22 | 10/1/29 | $671,000. | $154,166.66 | $516,833.34 |

The Commissioner of Internal Revenue proceeded in due course to an audit of Mr. Salvage's return. During this audit, as the Commissioner acknowledges (p. 8), Mr. Salvage furnished the Field Examiner with a memorandum prepared by Price Waterhouse & Company, the Company's auditors, which found a value as of December 30, 1922, for the old shares of $1164.70, and apportioned this value to the

* This took into account 25 shares of the old Company previously purchased by the taxpayer at $166.66 per share (Answer V (a) p. 12).

new preferred and common shares (Exhibit C, pp. 18-22). On the basis of this memorandum the Commissioner fixed the base value of the redeemed stock at $58,123.47, thereby adding to taxable income the sum of $96,043.19 and proposed an additional tax of $12,005.38. (See statement dated November 30, 1931, of Revenue Agent enclosed with Sixty Day Letter, pp. 7 and 8.)

Mr. Salvage, to protect his position, and although still contending that his theory of the return was correct, then filed a claim for refund asserting that if, as claimed by the Commissioner, an apportionment was practicable and the stock when acquired had a value of $1164.70 per share, that that figure and not the cash cost of $100. per share must be taken as the basis and if so taken he was entitled to a refund of $63,750.

Thereafter the taxpayer received the usual sixty day letter from the Commissioner and filed his petition for a redetermination of the proposed findings of the Commissioner, claiming *first,* then and at all times thereafter, that his return was correct, that it was in fact impracticable to make any fair apportionment as the company's books did not reflect the value of the shares of The Viscose Company on December 30, 1922, and, accordingly, that no taxable gain could have been received by the taxpayer until the whole amount paid by him for the stock had been recovered by him; and, *second,* if this claim were disallowed that the base cost of the preferred stock to the taxpayer was its actual value on the date when received by him, and not a fraction of the cost of $100. per share, and the difference between the two figures, representing the consideration for the stock purchase contract, was not taxable in 1929 (pp. 3, 5). The Commissioner's answer (p. 11) consisted of denials of the essential allegations and set out no affirmative defenses.

The Board of Tax Appeals disallowed all of the taxpayer's claims and sustained the apportionment made by the Commissioner on the basis of the Price, Waterhouse

memorandum supplied by the taxpayer (pp. 28-32). No matter relating to any affirmative defense was referred to in the opinion of the Board (pp. 28-32).

The taxpayer then filed his petition for a review of the Board's decision by the Circuit Court of Appeals for the Second Circuit (p. 32). In an opinion by Judge Swan (76 Fed. 2d. 112, R. pp. 73-78) the Court held that the difference between the cash cost to Mr. Salvage of the shares purchased in 1922 and the actual value represented income paid to him under the contract of December 30, 1922, in exchange for his covenant not to engage in a competing business, that the actual value was restricted as to five-sevenths of the shares by the price at which The Viscose Company had reserved the right of repurchase, and as to the balance was the value found by the Commissioner, i. e. $1,164.70 per share; that on this basis the taxpayer was entitled to a refund to compute which the case was ordered remanded. The Court further held that the taxpayer was not estopped by his failure to report as income in 1922 the difference between one hundred dollars per share and the true value.

From that decision the case has come to this Court on cross writs of certiorari.

## Specification of Errors.

1. In No. 173 the Commissioner specifies that the Circuit Court of Appeals erred:

In failing to hold that the taxpayer was estopped to claim that the basis for measuring the gain from the redemption of his new stock in 1929 was the fair market value of the old stock when acquired in 1922 by his failure to report the difference between the cost and fair market value as income for 1922.

2. In No. 280 the taxpayer specifies that the Circuit Court of Appeals erred in holding that the cost base of the preferred stock of American Viscose Corporation redeemed

in 1929 was to be arrived at by taking as the fair market value of The Viscose Company stock the sum of $100. per share, insofar as the five-sevenths of said stock which was subject to the option to repurchase was concerned.

3. In No. 280 the taxpayer specifies that the Circuit Court of Appeals erred in making a finding as to the value of said option stock.

## Summary of Argument.

The points of the petitioner Salvage are as follows:

1. The defense of estoppel is not available to the Commissioner. He argues that the statutes authorize the Board of Tax Appeals to make its own rules of practice and procedure; that the rules of the Board require that the Commissioner state any facts in his answer upon which he relies for affirmative relief, and that the burden of proof is upon the Commissioner to sustain any such defense; that the answer of the Commissioner in this case contained no plea of estoppel, and that had it done so the taxpayer would have been afforded an opportunity to present such facts as were available in opposition to such defense.

2. That even if the defense of estoppel is available to the Commissioner, nevertheless it is not established by the record. He argues that the elements held by the decided cases to be necessary to sustain a defense of equitable estoppel do not exist in this case; that there was no intended deception by the taxpayer nor was he guilty of gross negligence or constructive fraud; that the Commissioner had available means of acquiring all facts necessary to protect himself, and that the record does not show that the Commissioner was damaged in any way.

3. That the Circuit Court of Appeals erred in holding that five-sevenths of the 1500 shares of The Viscose Company stock subject to the option to repurchase had a value

of only $100. per share. He points out that by the terms of the contract itself the taxpayer purchaser was perfectly free to dispose of the stock and that if he had sold it the only right lying in the seller would have been an action for breach of contract; that a consideration of all the facts shown by the record, in connection with the relations existing between the purchaser and the seller of the stock, demonstrates that there was never any intention that the options to repurchase would be exercised, unless the purchaser breached his contract of employment; that even though the Court should hold that the repurchase options did diminish the value of the stock in 1922, the full value was received by the taxpayer as the options expired, and the difference was not subject to taxation in 1929.

4. That the Circuit Court of Appeals erred in making a new finding as to the value of the optioned stock. The argument on this point is based upon the contention that the Board of Tax Appeals from the evidence before it had found a value of $1,164.70 for all of the stock, including that which was subject to the option and that under the cases the Circuit Court of Appeals was obliged to accept this finding of fact as conclusive.

## POINT I.

**The defense of estoppel is not available to the Commissioner.**

The sole ground advanced by the Commissioner in his petition for a writ of certiorari is that the taxpayer is estopped from claiming that the basis for determining his gain is the true value of the stock acquired by him on December 30th, 1922. It is asserted in the petition for the writ (pp. 8, 9) that:

> "The case is one in which the taxpayer is claiming now that income was derived from the receipt

> of the stock in 1922 and a new basis established for measuring gain from the disposition of the stock in 1929, after he had previously taken the contrary position and induced the Government to rely upon it to the Government's detriment. There was thus a failure to disclose a transaction which the taxpayer was required to disclose in its sworn return, a reliance upon the taxpayer's act by the Government, and a subsequent reversal of position by the taxpayer to the Government's detriment. The existence of these elements is all that is required to establish equitable estoppel or estoppel *in pais*."

We submit that estoppel is an affirmative defense and, hence, must be pleaded and proven under the Rules of the Board of Tax Appeals and the authorities.

The Board has power to prescribe its rules of practice and procedure.

Section 907-(a) Revenue Act of 1924, as amended by Section 1000, Revenue Act of 1926 and Section 601 of the Revenue Act of 1928.

Rule 14 of the Board requires the Commissioner to file an answer which shall contain

> "A specific admission or denial of each material allegation of fact contained in the petition and a statement of any facts upon which the Commissioner relies for defense or for affirmative relief, or to sustain any issue raised in the petition in respect of which issue the burden of proof is by statute placed on the Commissioner."

The Board in a recent decision held that estoppel must be pleaded and proven. *Swiss Oil Co.* v. *Commissioner,* 32 B. T. A., decided June 14, 1935.

See also

*Sugar Creek Coal & Mining Co.,* 31 B. T. A. 344, 346.

*Helvering* v. *Brooklyn City Ry. Co.,* 72 F. (2d) 274.

*Gilmer* v. *Poindexter,* 10 Howard 257.

The Commissioner's answer (pp. 11, 12) contains no mention of an estoppel, and that defense was never presented until it was urged in the Commissioner's brief on the reargument in the Circuit Court of Appeals. The taxpayer's position, which it is now claimed he was estopped from taking, on the other hand was clearly presented in his petition to the Board. He alleged:

> "As a consideration of the right given to the taxpayer he agreed that he would not at any time during his life engage in any trade, business, or occupation for the manufacture or production of artificial silk or any material, goods, or articles from the same, nor enter into the service of any person, firm, or corporation engaged in such business, without the express written consent of said company. A copy of said contract is hereto annexed and marked 'Exhibit C'." (p. 3)
>
> * * * * * *
>
> "Wherefore, petitioner prays that this Board may hear the proceeding and determine:
>
> * * * * * *
>
> (2) That the base cost of the preferred stock to the taxpayer was its actual value on the date when received by him and not a fraction of the sum of $100. per share.
>
> (3) That no taxable gain was realized by the taxpayer upon the redemption of the preferred stock of American Viscose Corporation in 1929." (p. 5)

Had the issue of estoppel been raised by the Commissioner, either by his pleadings or on the trial, for aught that appears, the taxpayer might have been able to show he had no taxable income in 1922 on any basis of computation or that the Commissioner was fully advised of the transaction when the return was audited, or, as the Circuit Court of Appeals states in its opinion, that he might "for all that this record discloses, have mentioned the purchase in his 1922 return" (p. 77). He might further have shown that the equities lay against the Commissioner. On cross-

examination by the Commissioner's counsel Mr. Salvage was asked (p. 42):

> "Q. Can you state whether the Viscose Company in 1922 made any deduction in its return for salary or compensation paid to you other than that which you reported in your return?
>
> A. No; it did not.
>
> Q. Are we to understand, then, that the Viscose Company made no deduction by reason of the value of this stock over and above $100.?
>
> A. It did not * * *."

Had The Viscose Company made such a deduction it would have saved in taxes 12½% thereof. There is nothing to show that this gain by the Treasury exceeds the loss, if any, that it may have suffered by the failure of the taxpayer to report his purchase in accordance with the bargain-purchase theory promulgated by the Commissioner for the first time about a month before the taxpayer's return was due in a Treasury Department ruling.

The case was tried for the Commissioner before the Board on the theory that the difference in value of the shares purchased on December 30th, 1922, between the cash purchase price of $100. and the true value was not compensation for services. To now urge estoppel is, in effect, an admission to the contrary.

> "After bringing and trying the case on that theory the plaintiff can not be permitted on this review to change to another which the defendant was not required to meet below". *Virginian Ry. Co.* v. *Mullens,* 271 U. S. 220, 227, 228.

## POINT II.

**If the Court shall hold that equitable estoppel is available to the Commissioner as a defense, nevertheless it is not established by the record.**

This Court has defined equitable estoppel—the defense here urged—in a number of cases from which we quote the following:

> "For the application of that doctrine there must generally be some intended deception in the conduct or declarations of the party to be estopped, or such gross negligence on his part as to amount to constructive fraud, by which another has been misled to his injury. 'In all this class of cases', says Story, 'the doctrine proceeds upon the ground of constructive fraud or of gross negligence, which in effect implies fraud. And, therefore, when the circumstances of the case repel any such inference, although there may be some degree of negligence, yet courts of equity will not grant relief. It has been accordingly laid down by a very learned judge that the cases on this subject go to this result only, that there must be positive fraud or concealment, or negligence so gross as to amount to constructive fraud.' 1 Story's Eq. 391."
>
> (*Brant* v. *Virginia Coal & Iron Co. et al.*, 93 U. S. 326, at pp. 334, 335.)

> "The principle of estoppel is well settled. It precludes a person from denying what he has said or the implication from his silence or conduct upon which another has acted. There must, however, be some intended deception in the conduct or declarations, or such gross negligence as to amount to constructive fraud. *Brant* v. *Virginia Coal & Iron Co.*, 93 U. S. 326; *Hobbs* v. *McLean*, 117 U. S. 567. And in respect to the title of real property the party claiming to have been influenced by the conduct or declarations must have not only been destitute of knowledge of the true state of the title, but also of any con-

venient and available means of acquiring knowledge. Where the condition of the title is known to both parties, or both have the same means of ascertaining the truth, there can be no estoppel. *Brant* v. *Virginia Coal & Iron Co.*, supra."

(*Crary* v. *Dye*, 208 U. S. 515, at p. 521.)

"Only where conduct or statements are calculated to mislead a party and are acted upon by him in good faith to his prejudice can he invoke them as a basis of such an estoppel."

(*Oklahoma* v. *Texas*, 268 U. S. 252 at page 257.)

"The circumstances presented by this record do not show that the assured was deceived or misled to his detriment."

(*Wilber Nat. Bank* v. *United States*, p. 405, Vol. 79, No. 7, Sup. Ct. Advance Opinions.)

"An equitable estoppel is raised when there is some intended deception in the conduct or declarations of the party to be estopped, or such gross negligence on his part as to amount to constructive fraud, by which another has been misled to his injury."

(*Hobbs* v. *McLean*, 117 U. S. 567, at p. 580.)
See also Bigelow on Estoppel, 6th Ed. p. 682.

The application of these definitions to the present case raises the following questions:

(a) Is there any intended deception found in the conduct or declarations of the taxpayer?

(b) Was the taxpayer guilty of such gross negligence as to amount to constructive fraud?

(c) Was the Commissioner destitute of any convenient and available means of acquiring knowledge?

(d) Assuming the taxpayer's conduct or statements were calculated to mislead the Commissioner, were they acted upon by him in good faith and to his prejudice?

We believe the record clearly answers these questions in favor of Mr. Salvage. In the first place, never at any time either in the record or in the briefs has any suggestion been made that the taxpayer did not act in entire good faith. The Circuit Court of Appeals said (Rec. pp. 76, 77):

> "So far as appears, the petitioner's failure to report the income in 1922 was due to an innocent mistake of law; he made no false representations of fact, and may, for all that this record discloses, have mentioned the purchase in his 1922 return."

Moreover, when Mr. Salvage purchased his shares in 1922 the "bargain purchase" theory was not known.

T. D. 3435 promulgated February 7, 1923, II-1 C. B. 50, was the first announcement of the so-called "bargain purchase" theory. It provided in substance that,

> "Where property is sold by a corporation to a shareholder or member, or by an employer to an employee, for an amount substantially less than its fair market value, such shareholder or member of the corporation or such employee shall include in gross income the difference between the amount paid for the property and the amount of its fair market value. In computing the gain or loss from the subsequent sale of such property its cost shall be deemed to be its fair market value at the date of acquisition."

The bargain-purchase theory has since been approved in many decisions and is now Article 22(a)-1 of Regulations 86.

It is true that this Treasury decision was promulgated a little more than a month before the taxpayer filed his 1922 income tax return but there is no evidence that it was in general circulation by that time or that it came to his notice. Certainly the situation is not such as to furnish a basis for a charge of intended deception or gross negligence.

The basis of the taxpayer's 1929 return would seem to be immaterial in view of the fact that it was promptly audited by the Commissioner and every detail of the stock

purchase and redemption disclosed not later than November 30, 1931 (Statement of Revenue Agent, pp. 6, 7, 8). No question of the taxpayer's good faith has been or can be raised in connection with his 1929 return. He adopted as the basis for his 1929 return Article 1567 of Regulations 62, issued under the Revenue Act of 1921, which provided in part:

> "If property is exchanged for two kinds of property and no gain or loss is recognized under Articles 1564 or 1566, the cost of the original property should be apportioned if possible between the two kinds of property received in exchange for the purpose of determining gain or loss upon subsequent sale. If no fair apportionment is practicable no profit on any subsequent sale of any part of the property received in exchange is realized until out of the proceeds of sale shall have been recovered the entire cost of the original property."

As shown by his return he deducted from the proceeds of the redemption of the preferred stock the entire cost of his original stock purchase and reported the difference as a capital net gain (Schedule D, p. 27). This was a simple and straightforward method which left the entire proceeds of all future sales of stock taxable. The reason for its adoption is found in the case of *The Viscose Company*, 3 B. T. A. 444, 458, in which the Board found as to the capital of the Viscose Company

> "• • • it is impossible to determine the value of the mixed aggregate of tangible and intangible property."

The conditions of the business which brought the Board to that conclusion still obtained in 1929 according to the testimony of Mr. Salvage (pp. 39, 40, 41). Briefly, these were omission from the capital account (1) of expenditures for plant development paid from current income; (2) of the value of contract and patent rights; and (3) of secret processes (see also petitioner's Exhibits 6, p. 59; 7, p. 63; 8, p. 65).

The Board of Tax Appeals, however, sustained the Commission's allocation (p. 31) based on the Price, Waterhouse memorandum (p. 18) which Mr. Salvage had with commendable frankness supplied the Auditing Field Agent (p. 8). The Circuit Court of Appeals held that:

> "The taxpayer has not proved that the market value ascribed by the Board to preferred and common stock was erroneous or that no fair apportionment between them of the cost of the old stock was practicable" (p. 78).

As there is relevant evidence to sustain these conclusions we take it that the taxpayer is foreclosed from further argument to sustain his original position (*Phillips* v. *Commissioner*, 283 U. S. 589) but the facts do sustain his continued good faith.

Under the definitions, the Commissioner in order to succeed on the defense of equitable estoppel must also establish that he was destitute of any convenient and available means of acquiring knowledge. The Revenue Act in effect in 1921 required the taxpayer to keep adequate records of all business transactions and gave the Commissioner full authority to audit the taxpayer's records (Article 1711, Reg. 62). Had such an audit been made with respect to the year 1922, as it was made with respect to the year 1929, there is no reason to suppose that the same disclosure as was made by the taxpayer concerning his 1929 transactions would not likewise have been made concerning his 1922 transactions. No evidence was offered by the Commissioner as to whether or not any such audit was made, and if he failed to avail himself of the convenient means of acquiring full knowledge of the facts relevant to Mr. Salvage's income tax liability, is he not the one to suffer the consequences?

For all that appears in this case, the purchase of this stock was disclosed by the taxpayer in his 1922 return. That return was in the Commissioner's possession and if he had had the slightest idea of attempting to prove an

estoppel as against the taxpayer he should have placed it in evidence.

Finally, under the definitions of equitable estoppel, we have the question of whether the Commissioner was in fact misled and damaged. In the preceding point, (*ante*, p. 10) to which we respectfully refer the Court, it has, we believe, been shown that evidence of damage or prejudice to the Commissioner is totally lacking and that it is indeed possible that as a result of all of the transactions the Treasury Department may be the gainer. The evidence on these matters was in the possession of the Commissioner. Under the authorities the burden of proof was upon him and we submit that, as no such evidence was introduced, he has failed to sustain that burden and the defense of equitable estoppel must be dismissed.

> "But, if the question of the essential unfairness of this petitioner's position be open to consideration, there is still not enough to support the respondent's affirmative plea. The petitioner has not misled the respondent. So far as the evidence shows, petitioner has merely filed erroneous returns in which the Commissioner has acquiesced. There is no explanation of the error by either side. Both have known all the facts, certainly since 1922, and we may assume, in the absence of contrary evidence at least, that the Commissioner before that did his official duty and likewise ascertained them." *Sugar Creek Coal & Mining Co.* v. *Commissioner of Internal Revenue*, 31 U. S. Bd. Tax Ap. Repts, 344, at p. 347. Acquiesced in by Commissioner XIV.-1, C. B., p. 20.

## POINT III.

**The Circuit Court of Appeals erred in holding that five-sevenths of the 1500 shares of Viscose stock subject to the option to repurchase had a value of only $100. a share.**

The Circuit Court of Appeals in its opinion (p. 78) said:

> "Because of the option, each optioned share of Viscose had a value of only $100., and the block of

> American Viscose for which it was exchanged also had a value of only $100. because as a block it was subject to the option."

Putting it another way, the court held that stock having an admitted *value* of $1,164.70 a share, was immediately reduced to a *value* of only $100. a share because of the option to repurchase at that figure.

The option contract appears at p. 10 of the record. It is essential to consider its terms carefully to determine what effect, if any, it had upon the *value* of the 1500 shares of Viscose stock sold to Salvage.

The contract recites that the company

> "has in consideration of the agreement of Salvage hereinafter set forth, *sold to him or his nominees* 1500 shares of its capital stock at par, *and has issued certificates therefor as directed by Salvage.*" (Italics ours.)

Salvage on his part agreed that the company

> "shall have the right to repurchase from him *or his nominees,* and he does hereby undertake, on behalf of himself, his heirs, executors, administrators *and assigns, to procure for and deliver to* the said Company for repurchase at par the following proportions of the said 1500 shares." (Italics ours.)

The italicized language shows clearly that it was not intended that Salvage should during the life of the option retain the identical certificates of stock which had been issued "as directed by" him. On the contrary, it clearly appears that some of the shares were "sold to him or his nominees," otherwise there would have been no reason why he should "undertake, on behalf of * * * his * * * assigns, (i. e., nominees) to procure for and deliver to the said company" such shares as it might wish to repurchase.

There is nothing in the contract which would have prevented Salvage from assigning the entire 1500 shares to any number of assignees. There is nothing in the con-

tract which would have prevented him from selling or assigning the 1500 shares at $1,164.70 a share (their conceded fair market value) or at any other price obtainable. His agreement was "to procure for and deliver to the said company for repurchase at par" such shares as the company might, within the periods stated, conclude to repurchase. That agreement would have been complied with had Salvage delivered certificates for the called for number of shares, even though not the identical certificates originally issued to him or his nominees.

Since Salvage was free to dispose of the stock by sale or assignment for value, the stock did have a value in his hands in excess of $100. a share, and that value was $1,164.70 a share (p. 14).

As the option did not appear on the stock certificates themselves, it is clear that a purchaser from Salvage without notice, would, since a properly exeeuted assignment of a stock certificate makes it negotiable, have acquired a good title to the shares represented by the certificate. Even if it were possible to construe the option contract as requiring Salvage to sell back to the company the identical certificates originally issued to him, his failure or inability to do so, would merely be a breach of contract between him and the company and would not affect the rights of a purchaser from Salvage, or his assignee.

Salvage, therefore, was in a position where he could have sold the stock, and the buyer would have acquired a good title. Even though a suit for specific performance might have resulted, on the clearly untenable theory that his contract with the company would not be complied with if he delivered certificates other than those originally "sold to him or his nominees," nevertheless, his ability to sell and to give a good title clearly resulted in the stock having for him a value equivalent to its market value.

If it be contended that Salvage's agreement (see exchange of letters, R. p. 56) whereby he lodged the certificates with the company, put it beyond his power to sell,

nevertheless that did not destroy or reduce the *value* of his interest in the Viscose Company. That was a voluntary act on his part, and the Commissioner would not contend, if he were seeking to assess a tax against Salvage for the year 1922 on income represented by the difference between $100. a share and the fair market value of $1,164.70, that Salvage could by his own voluntary act of putting the evidence of his ownership in the Viscose Company beyond his own control, thereby reduce his taxable income $1,064.70 per share on 1500 shares.

Moreover, there is nothing in the record to even suggest that had Salvage requested the Viscose Company to return to him all or some part of the shares delivered pursuant to the letters of December 30th, 1922, (R. p. 56) that his request would not have been complied with.

The principles here set out are sustained by the decided cases.

In *Newman* v. *Commissioner,* 40 Fed. (2d) 225, (certiorari denied 282 U. S. 853) an agreement between stockholders provided that no one of them could sell without the assent of the others. The Circuit Court of Appeals for the Tenth Circuit, nevertheless held, that the taxpayer's gain was to be measured by the fair market value of the stock when received, even though it appeared that in two succeeding years the taxpayer had requested permission to sell and it had been refused.

In *Helvering* v. *Kendrick Coal & Dock Co.,* 72 Fed. (2d) 330, (certiorari denied 79 L. Ed. 534) the stock certificates provided that their transfer was subject to the provisions of the "Code of Regulations" of the issuing company. Despite this, the court held the stock had a market value.

In *Henritze* v. *Commissioner,* 28 B. T. A. 1173, the stock certificates bore on their face a restriction against sale, pledge, assignment or transfer prior to a certain date. The Commissioner contended that this restriction did not affect their market value, and the Board of Tax Appeals sustained

his contention and used their fair market value as the basis of income, just as if the restriction did not exist.

*Burns* v. *Commissioner*, 30 B. T. A. 163, 174;

See also:

*Rodrigues* v. *Edwards*, 40 Fed. (2d) 408;
*Wright* v. *Commissioner*, 50 Fed. (2d) 727;
*Tex-Penn Oil Co.*, 28 B. T. A. 917;
*Schneider* v. *Duffy*, 43 F. (2d) 642.

*Lincoln Bryant* v. *Commissioner of Corporations*, 197 N. E. 509, was an appeal to the Supreme Judicial Court of Massachusetts from the Board of Tax Appeals of Massachusetts. The question was whether income accrued to the taxpayer under the Massachusetts law upon the receipt on an exchange of shares of Massachusetts Utility Associates for shares of Class A stock of International Hydro-Electric System accompanied by an agreement that none of the latter stock would be disposed of without the consent of New England Power Securities Company for a period of one year. The taxpayer contended that he received no income from the exchange because the stock received could not be disposed of and therefore had no value. As to this contention, Rugg, C. J., said:

> "The limitation upon the sale of the Class A stock received by the taxpayer through the transaction was not inherent in the stock itself. It was not established by the charter or by-laws of the corporation by which it was issued. It did not appear on the face of the certificates. It was extraneous to the stock although accompanying its acquisition by the taxpayer. It arose out of a contract voluntarily made by the taxpayer with an outside party. The stock was not essentially unsalable. The same kind of stock, not held under such a contract, was freely sold in the market. The full and complete ownership of the Class A stock vested in the taxpayer at the time of the exchange. The title was absolute and unqualified, and not subject to condition. The con-

> tract did not prohibit the taxpayer from selling the stock; it permitted sale with consent of New England Power Securities Company. There is nothing in the record to indicate that the taxpayer ever sought that consent or that such consent would not have been given if requested. Attempts to restrict the normal operation of tax laws by the device of contracts on the part of the taxpayer strike at a vital function of government. They have not commonly been successful."

It is said in the Commissioner's "Memorandum for Respondent" (p. 8) that these cases are "to be distinguished from one in which the taxpayer voluntarily agrees not to sell his stock for a certain period." There may be such a distinction, but clearly there is a close analogy between an agreement not to sell to any one and an agreement to sell to a specified person (option). Both are restrictions upon the owner's disposition of his stock and both may be—and in this case were—voluntarily entered into. It is further said at the same page that *Wilson* v. *Bowers,* 57 Fed. (2d) 682, and *Markle* v. *Commissioner,* 10 B. T. A. 763, 794, support the view of the court below as to five-sevenths of the 1500 shares of Viscose Company stock.

*Wilson* v. *Bowers* involved an estate tax upon certain shares of a corporation held by decedent under agreements whereby others had the right to purchase at a fixed sum (provided the owner sought to sell to one not a party to the agreement) during the decedent's lifetime, and for a limited period from his estate in the event of his death. The executors sought to limit value to the agreed purchase price; the Commissioner contended for market value (the reverse of his position here), regardless of the limitations upon the salability of the stock. The court in discussing what constitutes a taxable estate under the Revenue Act of 1918 (estate tax) said these three elements must exist to give a taxable value, viz.:

1. The property must be subject to the payment of charges against decedent's estate, and

2. The expenses of its administration;

3. Subject to distribution as part of his estate.

No one of those three essential "characteristics", as the court called them, exists or need exist in a case like this, where the question is fair market value at the time of receipt by a living taxpayer. A fundamental distinction exists between "the interest therein of the decedent at the time of his death" as provided by the Estate Tax Law, and the *value* of shares of stock received by a living taxpayer, though subject to a repurchase option. This distinction is inherent in the laws, since the necessity for the existence of the "characteristics" of the estate tax does not exist with respect to income tax. If this were not true, then in those cases where "the taxpayer voluntarily agrees not to sell his stock for a certain period"—which the Commissioner apparently concedes are correctly decided—in the event of the taxpayer's death would not be subject to the estate tax, because they would not be subject to the payment of charges against the estate or expenses of administration, or subject to distribution. If the Commissioner's contention carried to its logical conclusion be sound, no simpler nor more effective method for evading estate taxes could possibly be devised.

The facts in *Markle* v. *Commissioner,* 10 B. T. A. 763, cited by the Commissioner in sustaining the decision of the court below are so different from those in this case that the Board's findings are valueless here. In the *Markle* case *all* the stockholders of a corporation gave an option upon their stock (10 B. T. A., p. 781) at $10.00 per share. They further agreed among themselves to sell at the same price (10 B. T. A. 782). This option and agreement were made *prior* to March 1, 1913, the basic date for ascertaining value, but were in effect on that date. It is not clear from the report of the case that the stock had any market value, or if it had any, it exceeded $10. a share; indeed it was possible under the circumstances existing that its value was not as

much as $10. per share, as appears from this language of the Board (p. 794):

> "They (i. e., the bondholders and stockholders) were also offered a flat cash price which, while netting the bondholders par plus accrued interest, would not have assured to stockholders anything over the $10., if that."

It rather appears from the Board's opinion that the $10. a share was taken as value, because there was no other satisfactory evidence upon which to base a different value.

For the *Markle* case to have any analogy to this case the facts here would have to be altered so that Salvage *prior* to the basic date for determining value, had given an option or entered into an agreement with *all other* stockholders of The Viscose Company to sell at $100. per share. Obviously when *all* stockholders of a corporation agree to sell at a fixed figure, that agreed figure determines the market value of the stock, but that situation does not exist in this case.

Summarizing the foregoing discussion, it is respectfully submitted that the court below erred because:

> The agreement of December 30th, 1922 (R. p. 10) did not prohibit Salvage from assigning for value all or any part of the 1500 shares of Viscose stock received by him,—on the contrary, it contemplated assignments. That Salvage if called upon to deliver to the company all or any part of five-sevenths of 1500 shares of its stock would have complied by delivering any other certificates for the required number of shares. That lodging the certificates with the company (R. p. 56) was his voluntary act and did not reduce their value from $1,164.70 a share to $100. a share. That there is nothing to show that if he had asked the company to consent to the sale of his stock it would not have done so.

Another method of considering the problem is to ascertain the purpose of the parties to and the substance of the agreement, as well as what advantages would be gained by the exercise or non-exercise of the rights given. (*Ithaca Trust Co.* v. *United States,* 299 U. S. 151; *G. & K. Mfg. Co.* v. *Commissioner,* 76 Fed. 2d 454, certiorari denied on this point No. 187 this term; *Newman* v. *Commissioner,* 40 Fed. 2d 225). In the two cases last cited the petitioners had purchased stock but had agreed not to sell within a limited period. The courts, looking at the intent of the parties, found that the agreements not to sell had been made for the advantage not only of other stockholders but of the purchasers themselves and held that the restriction in no way diminished the value of the stock. A careful examination of the record in this case shows clearly that the options to repurchase were retained only for the purpose of insuring petitioner's continuation in the service of the company and his non-competition, and that there was no intention that the options should be exercised unless petitioner broke his agreement.

Mr. Salvage was under an employment contract, (Exhibit 5, page 57) and the expiration of that contract on December 31, 1927, was coincident with the expiration of the last option to repurchase. The division of the stock into sevenths and the delivery of two-sevenths without restriction was made to compensate him fully for two previous years in which he had been underpaid (p. 43). He testified that the repurchase right was reserved in order to retain his services over a period of years (p. 38); that the company would not have sold him the stock unless he remained in its employ (p. 44); that he was willing to give the options because he was interested in the company and wished to remain (p. 44); that if the options had been exercised he would have left the company (p. 44). Mr. Salvage was the person largely responsible for the remarkable development of the company's business and his retention was obviously of great importance to the company (pp. 36, 37). The options were never exercised (p. 44), a

fact which is evidence that it was never intended that they should be unless petitioner broke his employment contract. See *Miller Industries* v. *Commissioner*, 61 Fed. 2d 412. The purpose is further shown by the application of the ordinary considerations of business conduct to the terms of the contract. The option to repurchase the entire five-sevenths of the stock, subject to the repurchase agreement, could have been exercised two days after the agreement was made. Is it conceivable that either the company or petitioner would have made such a futile agreement had there been any intention of exercising the option, which would have been so obviously to the company's advantage, had there been no other governing consideration?

Clearly the company considered it to its advantage not to exercise its right of repurchase unless petitioner broke his contract of employment, and the real option lay in him and not in the company.

Even though it be held that as of December 30, 1922, the option stock had a value of only $100. per share, nevertheless it is perfectly clear that as the options severally expired, the additional value came into the possession of the taxpayer, so that prior to 1929, the year here involved, he was in complete and unrestricted possession of all of the stock and all of its value had been received by him. The Commissioner has at all times in this case admitted, and indeed insisted, that the value of the stock, except as the same might be affected by the options, was $1,164.70 per share (stipulation, p. 14). The record also clearly demonstrates that the stock had at least this value in the years when the options severally expired (pp. 38-39).

Therefore, for the purpose of computing gain or loss in 1929, the options, whatever the Court may consider their original effect, should be disregarded and the stipulated and proven value of the old stock accepted. This value, upon apportionment, gives a basis of $110. per share for the preferred stock, the figure at which it was redeemed. No gain was realized and the taxpayer is entitled to the full refund claimed.

From all of which it appears that these 1500 shares had a fair market value on December 30th, 1922, when received by Salvage, of $1,164.70 a share, and accordingly the Circuit Court of Appeal's finding that only two-sevenths of the 1500 shares had that value should be reversed.

## POINT IV.

**The Circuit Court erred in making a new finding as to the value of the option stock.**

The jurisdiction of the Circuit Court is limited to a review of questions of law. *Avery* v. *Commissioner,* 22 F. (2) 6; *Tricou* v. *Commissioner,* 68 F. (2) 280, 286. While in certain cases the Circuit Court has considered questions not raised below, such questions are only considered when all the facts relevant thereto are before the Court. *Helvering* v. *General Utilities and Operating Co.,* 74 F. (2) 972; *Griffiths* v. *Commissioner,* 70 F. (2) 946. The Board of Tax Appeals sustained the Commissioner and found that all of the stock of The Viscose Company on December 30, 1922, had a value of $1,164.70 per share. Such administrative findings on issues of fact are accepted by the Court as conclusive if the evidence was legally sufficient to sustain them and there is no irregularity in the proceeding. *Phillips* v. *Commissioner,* 283 U. S. 589, 600. The only fact apparently considered by the Court in this instance was the contract itself. The circumstances relating to the value of the stock on the several dates of the expiration of the option were not in evidence, except as above indicated.

Respectfully submitted,

JOHN G. JACKSON,
*Attorney for Petitioner*
SAMUEL A. SALVAGE.

WILLIAM H. WHITE, JR.,
GEORGE B. BROOKS,
*of Counsel.*

FILE COPY

FILED
DEC 6 1935
CHARLES ELMORE CROPLEY
CLERK

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1935.

No. 173

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

*Petitioner,*

*vs.*

SAMUEL A. SALVAGE,

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

# BRIEF FOR RESPONDENT.

JOHN G. JACKSON,
*Attorney for Respondent,*
SAMUEL A. SALVAGE.

WILLIAM H. WHITE, JR.,
GEORGE B. BROOKS,
*of Counsel.*

# INDEX.


| | PAGE |
|---|---|
| OPINIONS BELOW | 1 |
| JURISDICTION | 1 |
| QUESTIONS PRESENTED | 2 |
| STATUTES AND OTHER AUTHORITIES INVOLVED | 2 |
| STATEMENT | 2 |
| SUMMARY OF ARGUMENT | 2 |
| ARGUMENT | 3 |
| POINT I. Neither the question nor of recoupment is properly before the Court for consideration | 3 |
| POINT II. The Revenue Act itself precludes the Commissioner from claiming either estoppel or recoupment | 6 |
| POINT III. The Commissioner has failed to establish his claim of estoppel | 7 |
| POINT IV. Other cases cited by Commissioner to sustain his claim of estoppel | 12 |
| POINT V. A consideration of the case of *Bull* v. *United States* | 17 |
| CONCLUSION | 18 |

CITATIONS.

CASES: PAGE

*Adler* v. *Commissioner*, 77 F. (2d) 733 ..... 14
*Alice State Bank* v. *Houston Pasture Co.*, 247 U. S. 240 ..... 5
*Askin & Marine Co.* v. *Commissioner*, 66 F. (2d) 776 ..... 14
*Avery* v. *Cleary*, 132 U. S. 604 ..... 11

*Bothwell* v. *Commissioner*, 77 Fed. (2d) 35 ..... 12
*Bull* v. *United States*, 295 U. S. 247 ..... 17
*Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359 .... 17

*Commissioner* v. *Liberty Bank & Trust Co.*, 59 F. (2d) 320 ..... 14
*Commissioner* v. *Moore*, 48 F. (2d) 526 ..... 16
*Continental Products Co.* v. *Commissioner*, 66 F. (2d) 434 ..... 15
*Crane* v. *Commissioner*, 68 Fed. (2d) 640 ..... 12, 14
*Clayton Magazines, Inc., In re*, 77 Fed. (2d) 852 (C. C. A. 2nd Circuit) ..... 18

*Dickerson* v. *Colgrove*, 100 U. S. 578 ..... 9
*Dolan* v. *Rodgers*, 149 N. Y. 489, 491; 44 N. E. 167 10
*Duesenberg, Inc.*, 31 B. T. A. 922, 926 ..... 4

*Giant Furniture Co.* v. *United States*, 9 F. Supp. 585 ..... 14
*Grouf* v. *State National Bank*, 40 Fed. (2d) 2 ..... 4
*Gunning* v. *Cooley*, 281 U. S. 463 ..... 5

*Haag* v. *Commissioner*, 59 F. (2d) 514 ..... 14
*Hartwell Mills* v. *Rose*, 61 F. (2d) 441 ..... 15
*Helvering* v. *Brooklyn City R. Co.*, 72 Fed. (2d) 274 16
*Helvering* v. *General Utilities & Operating Co.*, 74 Fed. (2d) 972, 976 ..... 4
*Helvering* v. *Morgan's Inc.*, 293 U. S. 121 ..... 17

PAGE

*Imperator Realty Co.* v. *Tull*, 228 N. Y. 447, 457; 127 N. E. 263 ..... 11

*Kirk* v. *Hamilton*, 102 U. S. 68 ..... 9

*Larkin* v. *United States*, 78 Fed. (2d) 951 ..... 7, 13

*Mahoning Investment Co.* v. *United States*, 3 F. Supp. 622 ..... 14
*Matern* v. *Commissioner*, 61 F. (2d) 663..... 15
*May Rogers*, 31 B. T. A. 994 ..... 4
*Merchants Heat & L. Co.* v. *Clow*, 204 U. S. 286.... 4, 5
*Moran* v. *Commissioner*, 67 F. (2d) 601..... 16

*Naumkeag Steam Cotton Co.* v. *United States*, 2 F. Supp. 126 ..... 15, 16

*Oklahoma* v. *Texas*, 268 U. S. 252 ..... 9

*Philadelphia, Wilmington & B. Ry. Co.* v. *Howard*, 54 U. S. 307, 335 ..... 3

*Stearns Co.* v. *U. S.*, 291 U. S. 54 .....6, 9, 11, 15
*Stone* v. *Bank of Commerce*, 174 U. S. 412..... 8
*Swartz* v. *Commissioner*, 69 F. (2d) 633..... 14

*The Viscose Company*, 3 B. T. A. 444 ..... 8

*United States* v. *S. F. Scott & Sons*, 69 F. (2d) 728 16

*Webster Co.* v. *Splitdorf Co.*, 246 U. S. 463 ..... 5
*West* v. *Blakeway*, 2 Man. & G. 828, 839..... 10
*Wheelock* v. *Commissioner*, 77 F. (2d) 474..... 14

STATUTES:

Judicial Code, Section 240 (a) as amended ..... 2
Revenue Act of 1928, Sections 607 and 609....2, 3, 6, 18

MISCELLANEOUS:

T. D. 3435, II-1, C. B. 50 ..... 13
L. O. 1095, I-1, C. B. 313 ..... 7

IN THE

# SUPREME COURT OF THE UNITED STATES,

OCTOBER TERM—1935.

**No. 173.**

GUY T. HELVERING, Commissioner of Internal Revenue,
*Petitioner,*
*against*
SAMUEL A. SALVAGE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

---

## BRIEF FOR RESPONDENT.

### Opinions Below.

Memorandum opinion of Board of Tax Appeals (R., 2832) is unreported. The opinion of the Circuit Court of Appeals (R., 74-78) is reported in 76 Fed. (2d) 112.

### Jurisdiction.

The judgment of the Circuit Court of Appeals was entered March 25, 1935 (R., 78). An order granting an extension of time thirty days from June 25, 1935, for filing a petition for certiorari was issued June 25, 1935 (R., 79).

The petition for a writ of certiorari was filed July 25, 1935, and granted October 14, 1935. The jurisdiction of this court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1935.

## Questions Presented.

The claim of the Commissioner in this matter is that the taxpayer is estopped to claim a refund of taxes paid in 1929 by reason of his failure to include in his return for the year 1922 as taxable income the difference between the real value of stock of The Viscose Company received by him in that year and the amount in cash which he paid for the same. In his brief he also argues that even though the taxpayer is not so estopped nevertheless the Commissioner is entitled to recoupment against the taxpayer's claim.

## Statutes and Other Authorities Involved.

The applicable statutes and other authorities involved are set forth in the appendix, pages 23 to 26, to the brief filed by the Commissioner herein. In addition, Section 607 and Section 609 (a) of the Revenue Act of 1928 are involved.

## Statement.

The essential facts are set forth in the brief filed by the Commissioner herein and the briefs of the Commissioner and the taxpayer in Samuel A. Salvage, petitioner, against Guy T. Helvering, Commissioner of Internal Revenue, No. 280.

## Summary of Argument.

The taxpayer contends in this case, first, that neither the claim of estoppel nor of recoupment is available to the Commissioner by reason of the fact that he failed to plead

the same as affirmative defenses; second, that the provisions of Sections 607 and 609 (a) of the Revenue Act of 1928 preclude him from succeeding in such claims; and, third, that even though said defenses were available the facts in the record do not sustain the Commissioner's contentions, he having failed to prove the elements necessary to establish estoppel or recoupment.

## Argument.

At the outset we submit two points which we believe are sufficient to dispose of the Commissioner's contentions, without further consideration of the cases cited by him in support thereof.

## POINT I.

**Neither the question of estoppel nor of recoupment is properly before the Court for consideration.**

In our main brief we have stated reasons and authorities which we believe support this contention. In addition to the authorities there cited to support the claim that Rule 14 of the Board of Tax Appeals is clear and explicit in its provisions and that the Board itself has construed it to require the pleading of estoppel as an affirmative defense, we submit the following:

In *Philadelphia, Wilmington & B. Ry. Co.* v. *Howard*, 54 U. S. 307, 335, the court says:

> "If a party has opportunity to plead an estoppel and voluntarily omits to do so and tenders or takes issue on the facts, he thus waives the estoppel and commits the matter to the jury who are to find the truth."

In the instant case the Commissioner was fully advised of the nature of the taxpayer's claim by his petition to the Board of Tax Appeals and had full opportunity to plead thereto.

In *Northport Shores Inc.*, 31 B. T. A. 1013, 1018, the Board stated:

> "Since estoppel is an affirmative defense respondent must prove all of its essential elements are present."

In *Duesenberg Inc.*, 31 B. T. A. 922, 926, the Board states:

> "But estoppel is a defense which must be pleaded and proved and since it was neither pleaded nor proved in the present case it deserves no further consideration."

In *May Rogers*, 31 B. T. A. 994, the Board says, referring to estoppel, at page 1004:

> "Aside from these considerations the answers of the respondent allege no facts on the question as required by Rule 14 of the Board's rules of practice. Beyond statements made by his counsel at the hearing he has not raised the issue." (Citing cases.)

See also *Grauf* v. *State National Bank*, 40 Fed. (2d) 2.

The requirement that an affirmative defense must be pleaded is not a mere technicality but is founded in reason. Without the plea the opponent has no opportunity to resist the new issue by amendment of the pleadings or by additional proof. *Helvering* v. *General Utilities & Operating Co.*, 74 Fed. (2d) 972, 976.

In connection with the claim now for the first time made by the Commissioner that he is entitled to recoupment the same reasoning applies. Recoupment is an affirmative defense. See *Merchants Heat & L. Co.* v. *Clow*, 204 U. S. 286. Reference is also made to Equity Rule 30.

An additional reason for not considering the plea of recoupment lies in the fact that the one error assigned by

the Commissioner in his application for a writ makes no reference whatsoever to this claim. This court will ordinarily not consider questions not certified to it. See *Alice State Bank* v. *Houston Pasture Co.*, 247 U. S. 240; *Webster Co.* v. *Splitdorf Co.*, 264 U. S. 463; *Gunning* v. *Cooley*, 281 U. S. 90.

In his brief the Commissioner relies on *Helvering* v. *General Utilities & Operating Co.*, supra, as authority for the proposition that estoppel was not required to be pleaded. This case is in fact authority to the contrary. No question of estoppel was involved and the only question was one of law as to the proper basis of computing tax liabilities from stipulated facts. The court says:

> "The reason for the rule, sometimes enforced by the courts, that an appellate court will confine itself to the issue presented and ruled upon by the court below, is based on the ground that the opposing party has no opportunity to resist the new issue by amendment of the pleadings or by additional proof. No such conditions exist here. No amendment to the pleadings is required to settle the issue here discussed, and no additional evidence could change the stipulated fact."

In the case now before the court a plea either of estoppel or recoupment would have permitted the taxpayer to establish whether or not the necessary elements thereof were present.

The question of lack of proof of estoppel we believe is sufficiently covered in our main brief. The reasoning in connection therewith applies even more strongly to the claim of recoupment. Recoupment is a cross demand seeking a credit against plaintiff's claim. Absolutely no proof has been presented as to the amount for which credit is claimed and there is no evidence in the record by which any Court could arrive at any figure.

## POINT II.

**The Revenue Act itself precludes the Commissioner from claiming either estoppel or recoupment.**

Section 607 and Section 609 (a) of the Revenue Act of 1928 read as follows:

> "Sec. 607. (Revenue Act of 1928). Any tax (or any interest, penalty, additional amount, or addition to such tax) assessed or paid (whether before or after the enactment of this Act) after the expiration of the period of limitation properly applicable thereto shall be considered an overpayment and shall be credited or refunded to the taxpayer if claim therefor is filed within the period of limitation for filing such claim."
>
> "Sec. 609. (Revenue Act of 1928). (a) Credit against barred deficiency.—Any credit against a liability in respect of any taxable year shall be void if any payment in respect of such liability would be considered an overpayment under section 607."

A reading of these sections shows that it was the clear intention of the Legislature that once a claim was barred by the statute the amount thereof could not be used by the Commissioner to offset an overpayment made in a subsequent year. The only modification that can be found in respect to this rule is in *Stearns Co.* v. *U. S.*, 291 U. S. 54, at page 60, where the court says:

> "The aim of that provision, as we view it, was to invalidate such a credit if made by the Commissioner of his own motion without the taxpayer's approval or with an approval falling short of inducement or request."

Certainly here there are no facts upon which to base a claim of such inducement or request. As a practical matter, under the construction given to these sections by the courts, if this taxpayer today paid a tax on his 1922 income

based upon the item in controversy (assuming any such tax would have been due) he could forthwith file a claim for and obtain a refund of the entire amount so paid.

See also L. O. 1095, I-1 C. B. 313.

The statute is in effect nullified if the claims of the Commissioner are allowed.

## POINT III.

**The Commissioner has failed to establish his claim of estoppel.**

The Commissioner rests his case on the claim that it was the taxpayer's duty to report as income in his 1922 return the difference between the cash cost of the shares of the old company and their fair market value; that his failure to so report constituted a representation to the Commissioner that no income had been received; that the Commissioner relied upon that representation to the Government's detriment—by reason of all of which the taxpayer may not now have his tax liability computed as prescribed by the Revenue Law in effect in that year but must accept some other basis of value fixed in accordance with a theory advanced by the Commissioner.

To support this claim the taxpayer is charged with "omission, concealment or wrongdoing" (p. 12, Commissioner's Brief), although it is admitted his return was made on the basis of an ordinary stock purchase which was the basis of all income tax returns of so-called bargain purchases prior to the announcement of Treasury Decision 3435 in February, 1923, more than a month after the stock purchase (Commissioner's Brief, p. 26), and although counsel for the Commissioner cites *Larkin* v. *United States* (78 Fed. (2d) 951), as holding that this Treasury Decision was only prospective in its operation and, hence, not applicable

to a purchase of stock in 1922. Inasmuch as a Treasury Decision is not legislation but simply an interpretation of existing law, we respectfully doubt the correctness of the holding in the *Larkin* case and refer to these matters only as showing that no basis exists for a charge against the taxpayer implying anything beyond an innocent omission from his 1922 return. Indeed the Circuit Court suggested that the failure to report might be due to an innocent mistake of law (R., p. 76).

In 1929 when the taxpayer was confronted with the problem of determining how much of the proceeds derived from the redemption of the American Viscose Corporation preferred stock was subject to income tax, for the reasons reviewed in our main brief and believing an apportionment was not practicable he made his return on that basis. In so doing he was supported by a decision of the Board of Tax Appeals (*The Viscose Company*, 3 B. T. A. 444) and he is not, we submit, subject to criticism for heeding the decision of the Board rather than an informal memorandum prepared by his accountants.

Mr. Salvage was at all times entirely willing that his tax liability should be determined on the basis of his returns as made and vigorously contended for such determination before the Board and the Circuit Court. It is the Commissioner who has driven him from that position and it is the Commissioner who is asserting that tax liability shall be determined on a basis other than that prescribed by the Revenue Law. It is the Commissioner, and not the taxpayer, who is seeking to make ineffective the Statute of Limitations and substitute therefor an expansion of the doctrine of equitable estoppel unsupported by any decision of this Court.

The Commissioner cites four cases in this Court in support of his contention (page 11) that the taxpayer's failure to report the income constituted in effect a representation to the Commissioner that no income had been received.

*Stone* v. *Bank of Commerce*, 174 U. S. 412, is a case in which the bank sought to estop the collection of certain

taxes by the State on the ground that the attorney for a collector had agreed that it would be taxed under a certain Act and that it could not be taxed under a subsequent Act. No damage was shown. The court held that no estoppel could properly be urged. The case is absolutely no authority for the Commissioner's contention.

In *Kirk* v. *Hamilton*, 102 U. S. 68, and *Dickerson* v. *Colgrove*, 100 U. S. 578, land was conveyed by persons having no legal right to give title. The respective true owners knew of the conveyances and in the first case remained silent while the land was improved and in the second affirmatively stated that the title would not be attacked. The court in each instance held that the conduct was such that they could not in equity change their positions. These cases obviously have no bearing here.

*Oklahoma* v. *Texas*, 268 U. S. 252, is authority, if anything, for the taxpayer. The court at page 257 says:

> "Only where conduct or statements are calculated to mislead a party and are acted upon by him in good faith to his prejudice can he invoke them as a basis of such an estoppel. And if they relate to the title of real property 'where the condition of the title is known to both parties, or both have the same means of ascertaining the truth, there can be no estoppel.'"

*Stearns Company* v. *United States, supra*, is the authority upon which the Commissioner apparently chiefly relies. In that case the taxpayer's returns for 1917 and 1918 were audited by the Commissioner. In June, 1923, the Commissioner made an additional assessment for the year 1917 of some $20,000., payment of which was demanded on August 3rd, 1923. On August 9th the taxpayer filed a claim for refund and credit of taxes alleged to have been overpaid for the years 1918, 1919, 1920 and 1921 amounting in the aggregate to over $35,000., and asked that the unpaid balance for 1917 be set off against the claim for overpayment and that the remainder be refunded. In June,

1924, the Commissioner allowed the claim of overassessment for 1918 in the sum of about $15,000. This overassessment was applied as a credit against the additional taxes due for 1917, leaving a balance of some $5,800. due the Collector which was on demand paid by the taxpayer without protest of any kind. Some six years later the taxpayer sued to recover the amount so credited, claiming that the Commissioner had been barred by the Statute of Limitations from making the additional assessment of 1917 taxes and, hence, the credit was improperly applied against that liability and should be refunded. Aside from a question as to the legality and effectiveness of a waiver of the statute signed by the taxpayer, the Court said with respect to the request to withhold the process of collection until credits were adjusted which the petitioner had filed with the Commissioner in August, 1923:

> "In substance the request was this: Please do not collect the tax for 1917, until you have completed the audit for the years 1918 to 1921 inclusive, and if there has been overassessment for those years, set it off as a credit" (p. 60).

The Court held that this amounted to something more than a waiver.

> "there was a positive request, which till revoked upon reasonable notice had the effect of an estoppel" (p. 59).
>
> * * * * * * *
>
> "The applicable principle is fundamental and unquestioned. 'He who prevents a thing from being done may not avail himself of the non-performance which he has himself occasioned, for the law says to him in effect "This is your own act, and therefore you are not damnified."' *Dolan* v. *Rodgers*, 149 N. Y. 489, 491; 44 N. E. 167; and *Imperator Realty Co.* v. *Tull*, 228 N. Y. 447, 457; 127 N. E. 263; quoting *West* v. *Blakeway*, 2 Man. & G. 828, 839. Sometimes the resulting disability has been characterized as an estoppel, sometimes as a waiver. The label counts

> for little. Enough for present purposes that the disability has its roots in a principle more nearly ultimate than either waiver or estoppel, the principle that no one shall be permitted to found any claim upon his own inequity or take advantage of his own wrong. *Imperator Realty Co.* v. *Tull*, supra. A suit may not be built on an omission induced by him who sues. * * * " (p. 61).

The foregoing case so differs from the case before the Court as to constitute no precedent. In the *Stearns Company* case the Commissioner received from and relied upon the "positive request" of the taxpayer, which induced the Commissioner not to act as he would have except for the request. The Court held the taxpayer's conduct to be inequitable and wrongful—thus completing the definition of an equitable estoppel, for the element of damage to the Commissioner was definitely established.

In the case before the court we believe the record clearly shows that the Commissioner's conduct in omitting to assess was not consequent upon any "positive request" or other inducement by the taxpayer, that the conduct of the taxpayer, which we have reviewed, was neither inequitable nor wrongful and that there is no evidence of damage to the Commissioner.

*Avery* v. *Cleary*, 132 U. S. 604, presents a close analogy. There a bankrupt omitted from his schedules and failed to disclose to the assignee in bankruptcy the existence of policies of insurance on the bankrupt's life. The bankrupt died and the proceeds of the policies were collected by the administrator of the bankrupt's estate for the benefit of his two daughters. The assignee in bankruptcy sued the administrator to collect the proceeds of the policies and the administrator pleaded that the suit was barred by the Statute of Limitations. The Court held with the administrator, saying (p. 610):

> "If it be assumed that Ellis had not, prior to his bankruptcy, delivered the assignment of May 19, 1877, and that his interests and rights in these poli-

cies were transferable to his assignee, the mere fact that he omitted any mention of the policies in his schedules in bankruptcy, and that neither he nor his administrator gave information of them to the assignee, would not establish fraud within the meaning of the rule announced in *Bailey* v. *Glover*. The omission from the schedules of any reference to the policies, and the failure to call the attention of the assignee to them, may have been caused by an honest belief, upon the part of Ellis, that they belonged to his children, or were not such property as the law required to be surrendered to the assignee; and, therefore, he lodged the assignment to Morse—possibly after his bankruptcy—with the insurance company."

The present case even more strongly negatives any wrongdoing, for it is clear that the taxpayer acted throughout in entire good faith.

## POINT IV.

**Other cases cited by Commissioner to sustain his claim of estoppel.**

In our main brief we have set forth the reasons why estoppel cannot be applied in this case under the general definitions, rules and precedents dealing with that defense. In this point we will confine ourselves to distinguishing the cases decided by the lower courts which are cited by the Commissioner in support of his contention.

The Commissioner (page 12) states that there are two cases in which the facts were almost identical with the facts in the case at bar, namely, *Bothwell* v. *Commissioner*, 77 Fed. (2d) 35, and *Larkin, et al.* v. *United States*, 78 Fed. (2d) 951. He also states that the case of *Crane* v. *Commissioner*, 68 Fed. (2d) 640, was a case similar in all respects.

In the *Bothwell* case, petitioners in 1922 received an option to purchase certain stock at $2.00 per share, which

was exercised in 1927, and the stock was sold in 1928 at a substantial profit. In their returns the petitioners returned the profit as a capital net gain. The Commissioner ruled that it was ordinary gain. Petitions were filed on the basis of the returns but subsequently, and after the statute had run against the year 1927, the petitions were amended to include a claim that the difference represented compensation for services in 1927. The Commissioner pleaded estoppel among other things. The Court held that compensation had not in fact been received but that in any event inasmuch as the taxpayers had *affirmatively asserted* in their returns and continued to assert until after the statute had run that the whole of the profit derived was capital gain they could not repudiate their position.

The case is clearly distinguishable in that (1) estoppel was pleaded; (2) the holding in respect to estoppel was not necessary to the decision; and (3) the petitions filed constituted positive assertions as to the legal position taken by petitioners and the Commissioner was entitled to rely upon these.

In the case of *Larkin et al.* v. *United States*, the opinion does not give sufficient information to determine whether or not the taxpayers, at the time they acquired the stock in question, should have known that the difference in value constituted taxable income. It does state that they were permitted to buy the stock "by reason of their long and faithful service." The case was in fact determined by the court upon the theory that T. D. 3435 II-1, C. B. 50, had not been promulgated at the time the stock was acquired, was not retroactive in effect and therefore that the difference in value did not in fact constitute taxable gain at that time. The language in respect to estoppel was not necessary to the decision. Moreover in the *Larkin* case the proceeding was initiated by the taxpayer; in the case before the Court the taxpayer has shifted his position under compulsion and solely by way of defense. While it is our view that the decision in this case was incorrect, nevertheless we submit that the above facts distinguish it.

*Crane* v. *Commissioner*. Contrary to the statement made at page 21 of the Commissioner's brief, the Board of Tax Appeals did not consider the question of estoppel, as a study of the record and of the opinion, 27 B. T. A. 360, shows. The Board decided the case solely on a question of statutory construction. In the Circuit Court of Appeals, although certain language indicates that the court had in mind estoppel, or something in the nature thereof, nevertheless the opinion does not use the word and in fact a careful study indicates that the Court also passed on the matter from the point of view of statutory construction. At page 641 the Court states:

> "It may be doubted whether the foregoing statutes and regulations require such a construction in all cases."

and further

> "The statutes and regulation should not be construed to entitle a taxpayer to the benefit of an expenditure made by his lessee, when the taxpayer has failed to report or to pay a tax in the appropriate year. * * *"

The concurring opinion of Judge Morton rejects the theory that failure to report income, however innocent, constituted a statement that no such income was received.

The Commissioner's brief cites a number of other cases as supporting his position without any analysis of the facts. A study of these cases shows that they are distinguishable from the case before the Court. In a number of them there was a positive and affirmative assertion contained either in the return involved or some other return, which assertion the taxpayer subsequently endeavored to repudiate. This is true of the cases of *Wheelock* v. *Commissioner*, 77 F. (2d) 474; *Haas* v. *Commissioner*, 59 F. (2d) 514; *Askin & Marine Co.* v. *Commissioner*, 66 F. (2d) 776; *Commissioner* v. *Liberty Bank & Trust Co.*, 59 F. (2d) 329; *Giant Furniture Co.* v. *United States*, 9 F. Supp. 585; *Swartz* v. *Commissioner*, 69 F. (2d) 633; *Adler* v. *Commissioner*, 77 F. (2d) 733; *Mahoning Investment Co.* v. *United States*,

3 F. Supp. 622; and *Matern* v. *Commissioner*, 61 F. (2d) 663.

The case of *Continental Products Co.* v. *Commissioner*, 66 F. (2d) 434, is similar to the *Bothwell* case. In that case the taxpayer filed a petition to the Board of Tax Appeals based upon a letter from the Commissioner which it stated was a deficiency letter, the filing of the petition of course staying the collection of any tax. After the statute had run it reversed its position and claimed that the letter did not constitute a deficiency letter and that the Commissioner's claim for tax was barred. It was held that the filing of the petition constituted an affirmative assertion by which the taxpayer was bound.

A similar case is *Hartwell Mills* v. *Rose*, 68 F. (2d) 441, where the taxpayer sought to recover an overpayment after the limitation period but had filed a claim for abatement which took it out of the operation of Section 607 of the Revenue Act. Subsequently he endeavored to argue that the claim for abatement was not legally filed and the Court held that he was precluded from urging this claim, saying that where the Government and the taxpayer by acquiescing in the manner of performing an act had given a definite character and effect to it, the taxpayer will not be permitted, after deriving benefits from its acquiescence, to deny its character or to change his position at the Government's expense.

The case of *Naumkeag Steam Cotton Co.* v. *United States*, 2 F. Supp. 126, is similar to the case of *Stearns Co.* v. *United States, supra*, in that it involves a positive request by the taxpayer to the Commissioner upon which the latter acted.

In all of the cases above cited the courts have made an effort to meet the requirements of equitable estoppel, to wit, intentional representation or inducement, reliance and damage. Either the representation or inducement has been found in an affirmative assertion contained either in a formal claim, the return or, as in the *Naumkeag* case, a direct request. In none of these cases has it been held that innocent omission of an item from the return constituted a representation upon which estoppel could be predicated. While

we do not concede that these cases are sound even on their own facts, nevertheless we believe that they are so distinguishable as to have no application in this case.

The cases of *Commissioner* v. *Moore,* 48 F. (2d) 526 and *Moran* v. *Commissioner,* 67 F. (2d) 601, are cases where the taxpayer adopted a certain theory of accounting, having or believing he had the option to treat income as having been received in one or more of several years. The effect of the decisions is simply that the taxpayer had made an election by which he was bound. It is to be noted that the Court in the *Crane* case used language indicating that they regarded the situation as similar, and indeed Judge Morton's concurring opinion specifically goes upon that ground, citing the *Moran* case.

The Commissioner endeavors to distinguish the cases of *United States* v. *S. F. Scott & Sons,* 69 F. (2d) 728, and *Helvering* v. *Brooklyn City R. Co.,* 72 Fed. (2d) 274. In respect to the *Scott* case, there is nothing in the record here to indicate that the Commissioner was not fully advised of the situation at the time of the audit of the 1922 return or in any event before the statute had run. The taxpayer returned the dividends on the stock and the Commissioner could, and presumably did, investigate both his records and the records of the corporation. *The Brooklyn City R. Co.* case, we submit is particularly applicable. Judge Hand there said:

> "The Commissioner argues that the opportunity to reassess the income both before and after 1921 has long since expired, and that he has lost this right because he relied upon the return as filed. This he must prove, for estoppel is an affirmative defense. In the first place it does not appear that he did not have immediate access to all the books of the taxpayer in every year in which a return was filed; he may have actually examined them. Therefore the record does not establish an estoppel * * *"

The Commissioner argues that in that case a cursory examination of taxpayer's books would have disclosed the error and that it was not shown that the tax for earlier years would have been greater. Both of these statements apply directly to this case.

## POINT V.

### A consideration of the case of Bull v. United States.

This court has not had occasion, so far as we have been able to ascertain, to consider the effect of the *Bull* case on other states of facts since that decision was rendered, and we, therefore, confine ourselves to pointing out the distinctions which exist between the respective states of facts and to what seems to us the logical application of the decision to this case in view of the general rules of law and other decisions of this court.

In the *Bull* case claim was made by the taxpayer, while here it is made by the Commissioner; there, there was an identical sum of money which was doubly taxed, while here there are two different items involved; there one tax year was involved, while here there are two different tax years; there the Government had actually received a sum of money while here the taxpayer has received nothing.

Since the Sixteenth Amendment was passed, income taxes have been consistently assessed on the basis of annual accounting periods, which periods have been known as taxable years, and the provisions of the taxing statutes have been drafted and enacted with primary reference to such normal accounting periods. *Helvering* v. *Morgan's Inc.*, 293 U. S. 121, *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359. Each year is governed by the particular Revenue Act applicable thereto, which defines income, both gross and net, and prescribes the rates of taxation. The taxpayer has the obligation to file a return and pay a tax for the annual period and the Collector has the right of collection. Thus the legal rights of the parties are fixed separately for each annual period and the whole scheme of the revenue acts has been to regulate the several tax periods as constituting different transactions between the parties.

To hold otherwise would necessitate proceeding upon the assumption that there is a continuous running account,

between the taxpayer and the government which permits a reopening of all past years—by the government in the event of a claim for refund and by the taxpayer in the event of a deficiency. That this was not the intent seems to us to be demonstrated by the terms of Section 607 and Section 609 of the Revenue Act of 1928, *supra*.

In the case of *In re Clayton Magazines, Inc.*, 77 Fed. (2d) 852 (C. C. A. 2nd Circuit), the court held the taxpayer could not offset a claim for refund against which the statute had run against a claim on the part of the Commissioner for additional taxes for a different year. We submit the distinction made by that court is sound.

So far as the claim might be made that the income here involved is in both years part of the same transaction or related to the same transaction, we point out that practically all profits arise from the investment or reinvestment of earned income and the interest and dividends received thereon, and almost any transaction relating to the disposition of property and taxation of the profits arising therefrom taking place in one year could be in some way related to transactions of previous years by tracing the source of the property back to the point when it came into the hands of the taxpayer either in the same or a different form.

## Conclusion.

It is therefore respectfully submitted that the decision of the court below should be affirmed in so far as it denies to the Commissioner the judgment for any deficiency and should be affirmed in so far as it allows to the taxpayer a refund and should be modified so as to allow to the taxpayer his full refund claimed of $63,750.

JOHN G. JACKSON,
*Attorney for Respondent,*
SAMUEL A. SALVAGE.

WILLIAM H. WHITE, JR.
GEORGE B. BROOKS
*of Counsel.*

FILE COPY

FILED
SEP 10 1936

No. 280

# In the Supreme Court of the United States

OCTOBER TERM, 1936

SAMUEL A. SALVAGE, PETITIONER

*v.*

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT*

## MEMORANDUM FOR THE RESPONDENT

# INDEX


| | Page |
|---|---|
| Opinions below | 1 |
| Jurisdiction | 1 |
| Question presented | 2 |
| Statutes and other authorities involved | 2 |
| Statement | 2 |
| Argument | 6 |
| Conclusion | 11 |
| Appendix | 12 |


## CITATIONS


| | |
|---|---|
| **Cases:** | |
| *Fesler* v. *Commissioner*, 38 F. (2d) 155 | 8 |
| *General Utilities & Operating Co.* v. *Helvering*, No. 41, October Term, 1935 | 10 |
| *G & K Mfg. Co.* v. *Commissioner*, 76 F. (2d) 454, No. 187, October Term, 1935 | 8 |
| *Helvering* v. *Kendrick Coal & Dock Co.*, 72 F. (2d) 330, certiorari denied, February 18, 1935 | 8 |
| *Ithaca Trust Co.* v. *United States*, 279 U. S. 151 | 10 |
| *Jackson Co., William H.*, v. *Commissioner*, 2 B. T. A. 411 | 10 |
| *Johnson* v. *United States*, 44 F. (2d) 244 | 10 |
| *Keller Mechanical Engineering Corp.* v. *Commissioner*, 6 B. T. A. 990 | 10 |
| *Markle* v. *Commissioner*, 10 B. T. A. 763 | 8 |
| *Miller Industries Co., H. H.*, v. *Commissioner*, 61 F. (2d) 412 | 10 |
| *Newman* v. *Commissioner*, 40 F. (2d) 225, certiorari denied, 282 U. S. 858 | 8 |
| *Robertson* v. *Routzahn*, 75 F. (2d) 537 | 10 |
| *Rodrigues* v. *Edwards*, 40 F. (2d) 408 | 8 |
| *Virginia* v. *West Virginia*, 238 U. S. 202 | 10 |
| *Wilson* v. *Bowers*, 57 F. (2d) 682 | 8 |
| **Statutes:** | |
| Revenue Act of 1921, c. 136, 42 Stat. 227, 237: | |
| Sec. 213 | 14 |
| Revenue Act of 1928, c. 852, 45 Stat. 791: | |
| Sec. 112 | 12 |
| Sec. 113 | 13 |
| **Miscellaneous:** | |
| I. T. 2335, VI–1 Cumulative Bulletin 18 | 17 |
| T. D. 3435, II–2, Cumulative Bulletin 50 | 16 |
| Treasury Regulations 62, Art. 1567 | 14 |


14841—35——1

# In the Supreme Court of the United States

OCTOBER TERM, 1935

No. 280

SAMUEL A. SALVAGE, PETITIONER

*v.*

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT*

## MEMORANDUM FOR THE RESPONDENT

### OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 49–56) is unreported. The opinion of the Circuit Court of Appeals (R. 135–140) is reported in 76 F. (2d) 112.

### JURISDICTION

The judgment of the Circuit Court of Appeals, reversing the decision of the Board of Tax Appeals in part and affirming it in part, was entered on March 25, 1935. (R. 140.) An order granting an

extension of time thirty days from June 25, 1935, for filing a petition for certiorari was issued June 25, 1935. The petition for a writ of certiorari was filed July 25, 1935. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

## QUESTION PRESENTED

Whether the Circuit Court of Appeals erred in holding that stock of the Viscose Company, subject to a gradually expiring option to repurchase at par, had a fair market value not in excess of its par value as of the date of acquisition by the taxpayer.

## STATUTES AND OTHER AUTHORITIES INVOLVED

The statutes and other authorities involved are set forth in the Appendix, *infra,* pp. 12–18.

## STATEMENT

The following facts are taken from the stipulation of facts, the memorandum opinion of the Board of Tax Appeals and the deposition of the taxpayer.

In 1929 the taxpayer received $671,000 from the redemption of 6,100 shares of preferred stock of the American Viscose Corporation. (R. 49, 51.) This stock had been acquired December 30, 1922, together with 7,625 shares of common stock, in exchange for stock of the Viscose Company, under the following circumstances:

In December, 1922, the taxpayer, an officer and employee of the Viscose Company, held 25 shares

of common stock of that company, which he had purchased at $166.66-2/3 a share. (R. 49.) At that time the Viscose Company increased its capital stock by 4,000 shares and permitted him to purchase 1,500 shares at $100 a share. (R. 83–91.)

This purchase was made pursuant to a contract of December 30, 1922, between the taxpayer and the Viscose Company. The contract in question provided that the corporation should sell 1,500 shares of stock to the taxpayer at par. In consideration the taxpayer agreed not to engage in any competing business and that the corporation should have the right to repurchase five-sevenths of the shares at par at any time during 1923, four-sevenths during 1924, three-sevenths during 1925, two-sevenths during 1926 and one-seventh during 1927. (R. 28–30.)

On the same date that this agreement was made with the Viscose Company (hereinafter called the old company), the American Viscose Corporation (hereinafter called the new company) was incorporated in Delaware and issued 4 shares of its preferred and 5 shares of its common stock in exchange for each share of common stock of the old company. (R. 24–25.) On that date the taxpayer exchanged his 1,525 shares, which had cost him an aggregate sum of $154,166.66, for 6,100 shares of new preferred and 7,625 shares of new common, pursuant to an agreement whereby the option attaching to the old shares was transferred to the

new. (R. 51, 103, 104.) The option was never exercised. (R. 51.)

In his 1929 return, the taxpayer reported as a gain from the redemption of the preferred stock, the difference between $671,000, the amount received, and $154,166.66, the entire cost of all the shares of the old company. (R. 51.)

The Commissioner determined a deficiency of $12,005.38 by ruling that 37.778 percent of the cost basis of the old stock should be apportioned to the new preferred stock and 62.222 percent of such basis to the new common stock. This apportionment was made according to the relative market values of the new preferred and new common stock at the time of the exchange. (R. 26, 27, 39, 49, 51–52.) This apportionment gave a basis of $58,123.47 for the preferred stock and was used by the Commissioner in measuring the gain. (R. 26.)

Before the Board the taxpayer contended that it was not practicable to determine the market value of the preferred and common stock as of December 30, 1922, that no apportionment of the cost basis of the old stock between the new preferred and new common stock should be made, and that the entire cost should be used as a basis. In addition, he claimed a refund of $63,750, based on the contention that the proper basis of the stock received in exchange for the 1,500 old shares was not the cost of such 1,500 shares ($100 per share), but their fair market value as of the time of their acquisition ($1,164.70 per share), on the theory that the dif-

ference represented compensation for services. (R. 4–5, 19, 52–53.)

The Board determined that the difference was not compensation for services and that neither the taxpayer nor the old company had so treated it for tax purposes. (R. 54–55.) It held that the basis was the cost of the old stock and that the basis was properly apportioned by the Commissioner. (R. 55–56.)

The court below, while agreeing that the difference between the cost and market value of the old stock was not compensation for services in 1922, held that it was income realized at that time from a promise not to engage in a competing business and that the taxpayer was not estopped to present this claim. It, therefore, held that the basis of the 1,500 shares was market value and not cost, but that only two-sevenths of those shares had a market value of $1,164.70 and the remaining five-sevenths a market value of $100 a share, because of the option for repurchase by the corporation, so that the aggregate market value was $606,300.

The court further held that the basis of the old shares ($4,166.66 for the 25 shares and $606,300 for the 1,500 shares) should be apportioned according to the method used by the Commissioner, which would apportion $230,662.09 to the preferred stock. Since this was in excess of the basis originally reported by the taxpayer, the court held that there was no deficiency and directed the Board to determine the amount of refund due.

ARGUMENT

While we believe that the question presented by this petition was correctly decided below and does not of itself merit review, we do not oppose the granting of the writ if a writ is granted upon the petition of the Commissioner in the same case, No. 173, present term. The questions presented in the two petitions involve the proper basis for computing gain on the same shares of stock, and it may be desirable that the Court have an opportunity to pass upon the question in its entirety.

If a writ is not granted in No. 173, we do oppose the granting of this petition.

The only issue raised by the taxpayer is whether the court below erred in reversing the Board's determination that all the common stock received by the taxpayer from his employer, the Viscose Company, on December 30, 1922, had a fair market value of $1,164.70 a share, and in holding that, with respect to the five-sevenths of the stock subject to an option to repurchase, the market value was $100 a share, the stated repurchase price.

There is no question but that the stock of the Viscose Company in general, as distinguished from that acquired by the taxpayer, had a fair market value of $1,164.70 a share. The Board so found and the court below did not disturb that finding but held that five-sevenths of the particular stock purchased by the taxpayer did not have such a value because of the option to repurchase. The fair

market value of those shares as distinguished from that of the stock in general is material solely because of the decision of the court below that the fair market value of the stock of the old company, rather than cost, constituted the basis for measuring the gain or loss from any subsequent disposition of the stock of the new company received in exchange for it, upon the theory that the difference constituted income received in 1922 in consideration of an agreement not to compete. (See T. D. 3435, II–2 Cumulative Bulletin 50, *infra*.) The fair market value of the old shares will not be material if this Court should sustain the Government's position in No. 173 that the taxpayer is estopped to deny that the basis is cost by virtue of his failure to report the difference between the cost and fair market value of the old stock as income in 1922.[1]

The taxpayer argues that the option agreement should not be taken into account in determining the

[1] Whichever basis is used, an apportionment of that basis between the new common and new preferred stock is required to ascertain the portion attributable to the preferred stock, and thus measure the gain realized from the redemption of the preferred stock in 1929. The court below apportioned the basis according to the respective market values of the two classes of stock at the time of the exchange without regard to restrictions on the taxpayer's particular stock. Since the new preferred as well as the new common stock was subject to this option, we believe that this procedure was correct and the taxpayer does not challenge it. The percentages assigned to the two classes are therefore the same as in the Commissioner's determination.

fair market value of five-sevenths of his stock and that if it should be, the Court should also have considered the fact that the option was released as to one-fifth of the five-sevenths each year and that it should have remanded the case to the Board to find the values of the stock as it was released from the option.

The taxpayer cites no authorities in support of his suggestion that stock subject to an option to repurchase at a price substantially below its market value has the same market value as stock not subject to option, and we know of none. *Wilson* v. *Bowers,* 57 F. (2d) 682 (C. C. A. 2d), and *Markle* v. *Commissioner,* 10 B. T. A. 763, 794, support the view of the court below that it does not have the same value.[2]

---

[2] This situation is to be distinguished from one in which the taxpayer voluntarily agrees not to sell his stock for a certain period. In such cases he has received an asset of a fair market value, equal to that of unrestricted stock, even though he has agreed to retain it for a period. *Helvering* v. *Kendrick Coal & Dock Co.*, 72 F. (2d) 330 (C. C. A. 8th), certiorari denied, February 18, 1935; *Newman* v. *Commissioner*, 40 F. (2d) 225 (C. C. A. 10th), certiorari denied, 282 U. S. 858; *Fesler* v. *Commissioner*, 38 F. (2d) 155 (C. C. A. 7th); *Rodrigues* v. *Edwards*, 40 F. (2d) 408 (C. C. A. 2d); *G & K Mfg. Co.* v. *Commissioner*, 76 F. (2d) 454 (C. C. A. 4th), now pending before this Court on petition for a writ of certiorari, No. 187, October Term, 1935, the granting of which has been opposed by the Government insofar as that issue is concerned.

We believe that the decision of the court below was clearly right on this issue and that in so holding it was not making a finding of fact as suggested by the taxpayer, but was ruling that the Board's finding that the stock had a fair market value of $1,164.70 was not supported by any substantial evidence in so far as the stock subject to the option was concerned, the evidence conclusively establishing that it had a fair market value equal to the option price.

The value of the stock as it was released from the option is not material. The old stock was never released from the option, but was exchanged for the new, and if market value is the basis for gain upon sale, as the taxpayer insists and the court below held, it is the market value of the old and not of the new which constitutes that basis. There is no question that the exchange of old shares for new was a non-taxable transaction. If market value is the proper basis, it is so upon the court's theory that the difference between the cost of the old stock and its fair market value when received in 1922 constiuted income at that time. Subsequent events changing the situation with reference to the new stock cannot be taken into account in fixing the fair market value of the old stock as of the time of its receipt in 1922.

But even if it had been the old stock which was released from the option, the same rule would

apply. It would be manifestly unreal to ascribe to stock a market value in excess of par in 1922 when at that time the stock was subject to an option to repurchase at that price. The fact that the option was not exercised and expired in subsequent years is immaterial. In determining the fair market value of property as of a given date, only such future events as could reasonably have been anticipated may be taken into account. *Ithaca Trust Co.* v. *United States,* 279 U. S. 151; *Johnson* v. *United States,* 44 F. (2d) 244 (C. Cls.); *Robertson* v. *Routzahn,* 75 F. (2d) 537 (C. C. A. 6th); *William H. Jackson Co.* v. *Commissioner,* 2 B. T. A. 411; *Keller Mechanical Engineering Corp.* v. *Commissioner,* 6 B. T. A. 990. Compare, *contra, H. H. Miller Industries Co.* v. *Commissioner,* 61 F. (2d) 412, 414 (C. C. A. 6th). See also *Virginia* v. *West Virginia,* 238 U. S. 202, 227.

Finally, the taxpayer suggests that the Court could not decide this issue, for the reason that the question was not raised in the court below. But the correct basis for the stock was in issue, all of the facts were before the court, and it had authority to notice a plain error, though not assigned, if it chose to do so. For further reply to that contention, we respectfully refer to our brief in opposition in the case of *General Utilities & Operating Co.* v. *Helvering,* No. 41, October Term, 1935.

## CONCLUSION

The taxpayer's petition presents no question of general importance and none in which there is any conflict of decisions. Hence the petition should be denied unless the petition in No. 173 is granted.

Respectfully submitted.

STANLEY REED,
*Solicitor General.*
FRANK J. WIDEMAN,
*Assistant Attorney General.*
JAMES W. MORRIS,
HELEN CARLOSS,
*Special Assistants to the Attorney General.*

SEPTEMBER, 1935.

## APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * *

(3) *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

* * * * *

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a

recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

(6) *Tax-free exchanges generally.*—If the property was acquired upon an exchange described in section 112 (b) to (e), inclusive, the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted by section 112 (b) to be received without the recognition of gain or loss, and in part of other property, the basis provided in this paragraph shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange.

This paragraph shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it;

* * * * *

Revenue Act of 1921, c. 136, 42 Stat. 227, 237:

SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items (except as provided in subdivision (e) of section 201) shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; * * *

Treasury Regulations 62, promulgated under the Revenue Act of 1921:

ART. 1567. *Gain or loss from subsequent sale.*—(a) Where property is exchanged for other property and no gain or loss is recognized under articles 1564 or 1566 the property received shall for the purpose of determining gain or loss from its subsequent sale

be treated as taking the place of the property exchanged therefor. But see article 1568. For exchange of property acquired prior to March 1, 1913, see article 1561. If property is exchanged for two kinds of property and no gain or loss is recognized under articles 1564 or 1566 the cost of the original property should be apportioned, if possible, between the two kinds of property received in exchange for the purpose of determining gain or loss upon subsequent sale. If no fair apportionment is practicable, no profit on any subsequent sale of any part of the property received in exchange is realized until out of the proceeds of sale shall have been recovered the entire cost of the original property. When securities of a single class are exchanged for new securities of different classes so that no gain or loss is realized under the provisions of paragraph (b) of article 1566, for the purpose of determining gain or loss on the subsequent sale of any of the new securities the proportion of the original cost, or other basis, to be allocated to each class of new securities is that proportion which the market value of the particular class bears to the market value of all securities received on the date of the exchange. For example, if 100 shares of common stock, par value $100, are exchanged for 50 shares of preferred and 50 shares of common each of $100 par value, and the cost of the old stock was $250 per share, or $25,000, but the market value of the preferred on the date of the exchange was $110 per share, or $5,500 for the 50 shares, and the market value of the common was $440 per share or $22,000 for the 50 shares of common, one-fifth of the original cost, or $5,000, would be regarded as the cost of the

preferred and four-fifths, or $20,000 as the cost of common. The same method of computation should be used in the case of stock acquired prior to March 1, 1913, in order to ascertain the proportion of such value to be allocated to each class of new securities on that date and the taxable gain or deductible loss should thereafter be computed in accordance with article 1561.

(b) Where property is compulsorily or involuntarily converted into cash or its equivalent in the manner described in sections 214 (a) (12) and 234 (a) (14) and the taxpayer proceeds in good faith to expend or set aside the proceeds of such conversion in the form and in the manner therein provided, the property acquired shall for the purpose of determining gain or loss from its subsequent sale be treated as taking the place of a like proportion of the property converted. See articles 261–263.

(c) Where no deduction is allowed by sections 214 (a) (5) and 234 (a) (4) for total or partial loss on sale or exchange of securities, that part of the securities acquired with relation to which such loss is disallowed shall for the purpose of computing gain or loss from a subsequent sale be treated as taking the place of the securities sold or disposed of. See article 147.

T. D. 3435, II–2 Cumulative Bulletin 50:

Where property is sold by a corporation to a shareholder or member, or by an employer to an employee, for an amount substantially less than its fair market value, such shareholder or member of the corporation or such employee shall include in gross income the difference between the amount paid for the property and the amount of its

fair market value. In computing the gain or loss from the subsequent sale of such property its cost shall be deemed to be its fair market value at the date of acquisition.

I. T. 2335, VI–1 Cumulative Bulletin 18:

REVENUE ACT OF 1926

"Where in a reorganization a stockholder receives in exchange for common stock in a corporation a party to a reorganization similar stock and other classes of stock in another corporation a party to the reorganization, he should allocate the cost of the common stock surrendered between the different classes of stock received in exchange in the proportion of the fair market values of such different classes of stock at the date of the exchange."

Request is made for information as to the proper basis to be assigned to each class of securities received by A in certain transactions. The transactions fall within the class of exchanges of stock and securities for other stock and securities in a reorganization in which no gain or loss is recognized under section 203 (b) 2 of the Revenue Act of 1926.

It is to be noted that there is no provision in Regulations 69 interpreting the Revenue Act of 1926 which corresponds to article 1567 of Regulations 62 interpreting the Revenue Act of 1921, which reads in part:

"* * * the proportion of the original cost, or other basis, to be allocated to each class of new securities is that proportion which the market value of the particular class bears to the market value of all securities received on the date of the exchange. * * *"

In the opinion of this office the provision of article 1567 of Regulations 62, quoted

above, lays down a principle which is equally applicable to reorganizations under the Revenue Act of 1926. (See article 1599, Regulations 69.)

In the event of the subsequent sale of stock received in a reorganization and the reporting of gain or less therefrom, the taxpayer should file with his return a statement showing the basis (computed in accordance with the principle referred to) used for the determination of the gain or loss, together with any evidence he may have to support such basis.

U. S. GOVERNMENT PRINTING OFFICE: 1938

FILED
NOV 26 1936

FILE COPY

No. 280

# In the Supreme Court of the United States

OCTOBER TERM, 1935

SAMUEL A. SALVAGE, PETITIONER

*v.*

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

*ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT*

## BRIEF FOR THE RESPONDENT

# INDEX


| | Page |
|---|---|
| Opinions below | 1 |
| Jurisdiction | 1 |
| Question presented | 2 |
| Statutes and other authorities involved | 2 |
| Statement | 2 |
| Summary of argument | 2 |
| Argument | 3 |
| Conclusion | 9 |


## CITATIONS


Cases:

| | |
|---|---|
| *Helvering* v. *Salvage*, No. 173, October Term, 1935 | 2 |
| *Ithaca Trust Co.* v. *United States*, 279 U. S. 151 | 5 |
| *Markle* v. *Commissioner*, 10 B. T. A. 763 | 8 |
| *Robertson* v. *Routzahn*, 75 F. (2d) 537 | 5 |
| *Wilson* v. *Bowers*, 57 F. (2d) 682 | 7 |

Miscellaneous:

| | |
|---|---|
| Treasury Decision 3435 II–1 Cum. Bul. 50 | 3 |

# In the Supreme Court of the United States

OCTOBER TERM, 1935

No. 280

SAMUEL A. SALVAGE, PETITIONER

*v.*

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

*ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT*

## BRIEF FOR THE RESPONDENT

### OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 28–32) is unreported. The opinion of the Circuit Court of Appeals (R. 74–78) is reported in 76 F. (2d) 112.

### JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 25, 1935. (R. 78.) An order granting an extension of time thirty days from

June 25, 1935, for filing a petition for certiorari was issued June 25, 1935. (R. 79.) The petition for a writ of certiorari was filed July 25, 1935, and granted October 14, 1935. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

## QUESTION PRESENTED

Whether the Circuit Court of Appeals erred in holding that stock of the Viscose Company, subject to a gradually expiring option to repurchase at par, had a fair market value not in excess of its par value as of the date of acquisition by the petitioner.

## STATUTES AND OTHER AUTHORITIES INVOLVED

The applicable statutes and other authorities involved are set forth in the Appendix, pages 23 to 26, to the brief filed by the Commissioner in *Guy T. Helvering, Commissioner of Internal Revenue* v. *Samuel A. Salvage,* No. 173.

## STATEMENT

The essential facts are set forth in the brief filed by the Commissioner of Internal Revenue in No. 173 and, in the interest of brevity, will not be repeated here.

## SUMMARY OF ARGUMENT

Where the owner of stock in a corporation contracts with it that it shall have the right to repurchase from him or his nominees such stock at a

certain price within a certain time, agreeing on behalf of himself, his heirs, executors, administrators, and assigns to procure for and deliver to the corporation such stock for repurchase at that price within that time, the fair market value of the stock while subject to such right of the corporation is the price at which the corporation has the right to repurchase. To ascribe to such stock while subject to such option to repurchase, a market value in excess of the agreed repurchase price would ignore the value of the option.

The court below concluded as a matter of law that the value of the stock subject to the option was the repurchase price fixed in the option agreement.

## ARGUMENT

The sole question presented in this case is whether the court below erred in holding, with respect to the five-sevenths of the stock subject to an option to repurchase, that its fair market value when received in 1922 was not in excess of $100 per share, the price at which it could be repurchased under the option agreement.

If that was the fair market value of such five-sevenths in 1922, such market value being not greater than the actual cost of such five-sevenths to taxpayer at that time, there was no difference between the cost and fair market value to treat as 1922 income to taxpayer, whether under Treasury Decision 3435, II–1 Cumulative Bulletin 50, promul-

gated February 7, 1923, or otherwise. There is, therefore, no foundation or room for the taxpayer's position that he received or was chargeable with returnable income on such five-sevenths in 1922.

Moreover, upon the unfounded assumption that the taxpayer did receive or was chargeable with returnable income on such five-sevenths in 1922, the fact is that he did not return any such income for 1922. If this Court should sustain the Government's position in No. 173 that the taxpayer is estopped to claim that the basis for determining the gain from the redemption of the stock in 1929 is the fair market value of such stock when acquired in 1922, then the question presented herein is no longer material.

Under the terms of the agreement (R. 54–55) the corporation was given the right to repurchase at par ($100) five-sevenths of the stock during 1923, four-sevenths during 1924, three-sevenths during 1925, two-sevenths during 1926, and one-seventh during 1927. Therefore, only two-sevenths of such stock was received outright by the taxpayer in 1922. The other five-sevenths was received subject to an option to be repurchased at $100 per share, the price paid by the taxpayer for the stock. It would be manifestly unreal to ascribe to such stock a market value in excess of $100, when at the same time the stock was subject to an option to repurchase at that price, and to do so would assign no value to the option.

The fact that the option subsequently expired unexercised is irrelevant to the fair market value of the stock in 1922. While "the event is always a great teacher", that value must be determined as of that time in the light of facts then known, future possibilities being given only such weight as then reasonably would have been accorded them as a foundation for action by one then purchasing the stock subject to the option. "Like all values, as the word is used by the law, it depends largely on more or less certain prophecies of the future; and the value is no less real at that time if the prophecy turns out false than when it comes out true." *Ithaca Trust Co.* v. *United States*, 279 U. S. 151, 155. No one, in 1922, contemplating purchasing the stock with knowledge of the option reasonably could or would have discounted the contingency that the option might be exercised by the corporation which had it. For the purpose of then estimating value the anticipation that the option would be exercised was exclusively reasonable; and only reasonable prophecy can be indulged. See *Robertson* v. *Routzahn*, 75 F. (2d) 537, 539 (C. C. A. 6th).

Nor is it relevant whether in 1922 a bona fide purchaser for value of the stock subject to the option might have acquired it from the taxpayer without notice of the option; for the issue is the fair market value to the taxpayer in 1922 of his stock and not the fair market value of similar stock of

the same corporation owned by others and subject to no option. The taxpayer cannot be heard to assert a market value premised upon the assumption that he had the power, as distinct from the right, so to dispose of the stock as to render it impossible for him to deliver the stock to the corporation if and when it should exercise its option. It is likewise irrelevant whether the intention of the taxpayer and the corporation was that the option should not be exercised so long as the former continued in the service of the latter and observed his agreement not to compete; for the contract places no such restriction on the right of the corporation to exercise its option. It was at all times until the option expired free to exercise it notwithstanding the taxpayer remained in the employ of the corporation and refrained from competition.

The taxpayer argues that the option agreement should not be taken into consideration in determining the fair market value in 1922 of the stock subject to the option, citing a number of cases in which there were restrictions against selling the stock for a certain period or against selling it to others without first offering it to certain parties or to other stockholders. But in those cases there was no restriction upon the price at which the stock was to be sold. Here the agreement named a fixed repurchase price and the fair market value of five-sevenths of the stock could not exceed that amount.

It is urged (Br. 27) that as the options expired the additional value came into the possession of the taxpayer, so that prior to the year 1929 he owned all of the stock subject to no restriction. But the effect of the expiration of the options was merely to increase the value of the stock in the hands of the taxpayer. There was then no realized gain. This being true, he may not claim that the market value of the stock, as and when freed from the option, is the proper basis for determining the gain from the redemption of the stock in 1929. Moreover, his case is based upon the theory that he realized income in the year 1922 to the extent of the difference between the cost of the stock to him and its then fair market value.

A similar case is *Wilson* v. *Bowers*, 57 F. (2d) 682 (C. C. A. 2d). There a decedent agreed not to sell or assign his shares without first offering them to his nephew at $6.66⅔ per share, and if the nephew did not accept, to one Betts. The agreement further provided that upon the death of the decedent they should have the right for a period of four months after the qualification of the executors to purchase the stock at the same price. In holding that the value of the stock was the amount for which it was subject to purchase under the option the court said (pp. 683–684):

> Since the contract was specifically enforceable, it seems obvious that the sale value of the stock during the testator's life could have been no more than the low price at which

> he was obliged to offer it, first, to Franklin Wilson, and then to Betts; nor could his executors have sold it for more, unless both the option holders had allowed their options to lapse. * * * Nor do we see the force of the appellant's argument that the holder of an option has no equitable interest in the property until the option is exercised. Williston, Contracts (2d Ed.) § 61. Granting this and accepting the appellant's analysis of the legal relations created by an option, the option holder's power to create a contract enforceable in equity was as effective to depress the value of the option giver's interest in the property subject to the option as would be the contract itself when created. So long as the option here involved was outstanding, the property could not be sold for more than the option price.

See also *Markle* v. *Commissioner*, 10 B. T. A. 763. There the Board held that the price at which stock could be purchased under an option was its fair market value.

The taxpayer in his brief (pp. 23–24) contends that the *Wilson* case, *supra*, is distinguishable for the reason that it involved estate taxes, whereas this case involves income taxes. But the fair market value of stock for estate-tax purposes is the same as fair market value for income-tax purposes.

The taxpayer also contends that the court below was without authority to find that the value in 1922 of five-sevenths of the stock was the option price

of $100 per share. The determination of the market value of the stock in 1922 was not contrary to any finding of the Board of Tax Appeals, because the Board found it unnecessary to determine the question, having held that the taxpayer acquired the stock by purchase and in no sense as compensation for services rendered the company. In determining that five-sevenths of the stock had a market value of $100 per share in the taxpayer's hands in 1922, the court below was deciding a question of law, namely, that the value was established by the price named in the option agreement.

## CONCLUSION

It is respectfully submitted that the decision of the court below on this issue should be affirmed.

STANLEY REED,
*Solicitor General.*
FRANK J. WIDEMAN,
*Assistant Attorney General.*
GOLDEN W. BELL,
*Assistant Solicitor General.*
ELLIS N. SLACK,
*Special Assistant to the Attorney General.*
JOHN R. BENNEY,
*Attorney.*

NOVEMBER 1935.

U. S. GOVERNMENT PRINTING OFFICE: 1935

# SUPREME COURT OF THE UNITED STATES.

Nos. 173 and 280.—October Term, 1935.

| | | |
|---|---|---|
| Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, | | |
| 173 | *vs.* | On Writs of Certiorari to the United States Circuit Court of Appeals for the Second Circuit. |
| Samuel A. Salvage. | | |
| Samuel A. Salvage, Petitioner, | | |
| 280 | *vs.* | |
| Guy T. Helvering, Commissioner of Internal Revenue. | | |

[January 13, 1936.]

Mr. Justice McReynolds delivered the opinion of the Court.

These cross writs bring up a judgment of the Circuit Court of Appeals, 2nd Circuit, which disapproved a deficiency assessment for 1929 income; and authorized recovery for overpayment below the taxpayer's claim.

The petition for certiorari in No. 173 asserts: "The question is—Whether the taxpayer is estopped to claim that the difference between the market value of the 1,500 shares as of December 30, 1922 and their cost to him constituted taxable income to him for 1922; and hence that the fair market value of these shares, and not their cost, is the basis to be used in measuring the gain from the disposition of the shares in 1929, no income from the transaction having been reported in 1922."

The points to be urged in No. 280 are stated thus—"The Circuit Court of Appeals erred: (1) In holding that the cost base of the preferred stock of American Viscose Corporation redeemed in 1929 was to be arrived at by taking as the fair market value of The Viscose Company stock the sum of $100 per share, insofar as the five-sevenths of said stock which was subject to the option to repurchase was concerned. (2) In making a finding as to the value of said optioned stock."

Prior to 1922, Salvage, the taxpayer, bought twenty-five shares, Viscose Company stock. He paid $166.66 for each one—for all

$4166.66. In December, 1922, he acquired from the corporation 1500 shares for which he paid $100 per share ($150,000) and entered into an obligation to refrain from competing business, etc. Also, he agreed that during 1923 the corporation might repurchase five-sevenths of 1500 shares at par; during 1924, four-sevenths, etc. Intrinsically (when unincumbered) a share of the company stock was then worth $1164.70.

Later during 1922, all these shares (1525) were exchanged for 6100 preferred shares, redeemable at $110, and 7625 common shares, American Viscose Corporation. The basis of exchange was four preferred and five common shares of new stock for one share of old. The taxpayer's return for 1922 (not in evidence) showed no gain from these transactions.

During 1929 American Viscose Corporation redeemed its preferred shares at $110; Salvage received $671,000. His return for that year disclosed as net capital gain the difference between that sum and $154,166.66, total outlay for the 1525 converted shares. Upon this, he paid the assessed tax. Apparently, he supposed apportionment between preferred and common stock of their total cost was impossible or unnecessary; also that no taxable gain arose before return of his entire outlay.

Upon an audit, the Commissioner ruled that proper apportionment of the total cost—$154,166.66—could be made. He assigned thirty-seven + percent to the preferred and sixty-two + percent to the common shares and made a deficiency assessment of $12,005.38. Thereupon, the taxpayer claimed, first that in 1922 each Viscose Company share was fairly worth $1164.70 and with that as the base, no taxable gain arose upon redemption of the preferred stock. Also that he had overpaid to the extent of $63,750. Second, that apportionment of the cost of both between preferred and common shares was impracticable and no taxable gain could arise prior to recovery of the full outlay.

Upon these conflicting claims, the Board of Tax Appeals took the matter. There the Commissioner asserted correctness of his action; he presented no affirmative defense; set up no claim of estoppel because of the taxpayer's failure properly to report 1922 gain.

The Board held the difference between the true value of Viscose Company shares and the price paid by the taxpayer was not com-

pensation for services; also that the deficiency assessment was properly made. Estoppel was neither presented nor considered.

The court below held that the consideration for the Viscose Company stock acquired in 1922 was $100 per share, plus the covenants to resell five-sevenths at par, etc. and not to engage in competing business. Also that the base cost for estimating capital gain in 1929 was the fair market value in 1922 of the shares then held. And since the corporation had the right to repurchase at par, the market value of five-sevenths did not exceed $100 per share. Further, that the failure to disclose 1922 taxable gain apparently resulted from innocent mistake of law; there was no false representation of fact; nothing gave support to the claim of estoppel. The cause was remanded for ascertainment of the amount of the overpayment.

We find no reason to disagree with the judgment of the court.

The defense of estoppel was not before the Board. Under what we regard as the correct practice, *General Utilities, etc. Co.* v. *Helvering*, No. 41—October Term, 1935, Decided Dec. 9, 1935, the court should have passed the point. Furthermore, the facts disclosed give it no support.

Considering the option to repurchase at par, outstanding in 1922, there could be no proper finding of fair market value at that time in excess of $100 per share. In the circumstances, the court did not err in so holding.

Pertinent Treasury Regulations, rulings and judicial opinions are adequately pointed out by the court's opinion.

The judgment is affirmed. The cause will be remanded for further proceedings.

*Affirmed.*